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JUSTICE DEPARTMENT INVESTIGATIONS OF DEFENSE PROCUREMENT FRAUD: A CASE STUDY

A STAFF STUDY

PREPARED FOR THE USE OF THE

SUBCOMMITTEE ON
NATIONAL SECURITY ECONOMICS

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

NOVEMBER 15, 1988

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LETTER OF TRANSMITTAL

OCTOBER 9, 1988.

Hon. PAUL S. SARBANES,
Chairman, Joint Economic Committee,
Congress of the United States, Washington, DC.

DEAR MR. CHAIRMAN: I am transmitting for the use of the committee and other Members of Congress a staff study entitled "Justice Department Investigations of Defense Procurement Fraud: A Case Study."

The study examines in detail the management by the Department of Justice of a major investigation of alleged defense fraud, and describes serious shortcomings in the conduct of the investigation and systemic problems in DOJ.

The findings are significant because of the great magnitude of defense procurement fraud and of government fraud in general. There have been many efforts to reform defense procurement in order to capture the billions of dollars lost through waste, fraud, and abuse. Procurement reform cannot succeed so long as there are systemic problems in the Justice Department's management of government fraud.

The study was a joint effort between my subcommittee of the Joint Economic Committee and the Office of Senator Charles Grassley who, at the time the study was begun, was chairman of the Senate Judiciary Subcommittee on Administrative Practice and Procedure. The study was written by Richard F Kaufman and Lisa Hovelson.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Subcommittee on
National Security Economics.

CONTENTS

Page
Letter of Transmittal III
Executive Summary VII
I. Introduction 1
II. The Newport News Case 3
  A. The Referrals 3
    1. Referral by Senator Proxmire to the Justice Department 3
    2. Referral by the Navy to the Justice Department 4
    3. Referral by the Justice Department to the U.S. Attorney 5
  B. The Richmond Phase 6
    1. The Richmond Investigation and Norman's Report 6
    2. Review by the U.S. Attorney and Norman's Supplemental Report 11
    3. Reactions to the Supplemental Report 13
  C. The Alexandria Phase 15
    1. The Alexandria Investigation by Fisher and Aronica 15
    2. The Fisher-Aronica Status Report 17
    3. Reorganization of the U.S. Attorney's Office 18
  D. The Justice Department Phase 19
    1. The Justice Department Reassumes Responsibility 19
    2. The Assignment of Ed Weiner 20
    3. Weiner's Review and Report 22
    4. The Fraud Section's Reaction and Weiner's Follow-Up Efforts 23
    5. Ogren and Silverstein Disagree With Weiner and Weiner Dissents 25
    6. The Ogren Report 27
    7. Critique of the Ogren Report 28
    8. The Statute of Limitations Problem 30
    9. The Decision To Close the Investigation 31
III. Defense Procurement Fraud and the Justice Department 33
  A. The Views of Jensen and Olsen 33
  B. The Defense Procurement Fraud Unit 34
IV. Summary and Conclusions 38
  A. The Newport News Investigation 39
  B. The Defense Procurement Fraud Unit 41

APPENDIX EXHIBITS

A. May 19, 1977—Letter From NAVSEA 08 (Rickover) to Inspector General, NAVSEA 43
B. July 14, 1977—Letter From NAVSEA 08 (Rickover) to Inspector General, NAVSEA 47
C. November 1, 1977—Letter From NAVSEA 08 (Rickover) to Inspector General, NAVSEA 51
D. December 30, 1977—Letter From NAVSEA 08 (Rickover) to Secretary of the Navy 59
E. January 3, 1978—Letter From NAVSEA 08 (Rickover) to Secretary of the Navy 81
F. January 5, 1978—Letter From NAVSEA 08 (Rickover) to Secretary of the Navy 89
G. February 8, 1978—Memo From Mark M. Richard to John C. Keeney, re: Shipbuilding Referrals From the Department of the Navy 105
H. February 15, 1978—Memo From Mike Kelly to Benjamin Civiletti, re: Judge Bell's Comments to Memo 107

Page

I. April 12, 1978—Letter From John C. Keeney to Deanne Siemer, re: Navy Referrals 111
J. June 2, 1978—Letter From NAVSEA 08 (Rickover) to the Secretary of the Navy 115
K. July 19, 1978—Letter From NAVSEA 08 (Rickover) to the Secretary of the Navy 123
L. 1979—Response of U.S. Government to Newport News Motion To Terminate Grand Jury Proceedings 131
M. December 3, 1979—Memo From Linda Pence on Navy Recruiting Claim 185
N. March 1980—Paulisch "Bow Dome" Memo 213
O. March 5, 1980—Memo From Saundra Adkins on Norman Prosecution Memo 241
P. April 4, 1980—Memo From Jo Ann Harris to Jim Graham et al., re: Meeting With ADM Rickover on Navy Recruiting 281
Q. October 1, 1980—Norman Prosecution Memo 285
R. October 1980—Norman Supplemental Prosecution Memo 383
S. January 23, 1981—Letter From Undercofler to Renfrew 457
T. November 2, 1981—*White Collar Crime Priorities, Eastern District of Virginia* 461
U. November 1981—Fisher-Aronica Status Report 491
V. November 1981—Fisher-Aronica Status Report Appendix 581
W. August 5, 1982—Weiner Memo 693
X. September 1, 1982—Memo From Smith to Ogren 709
Y. November 17, 1982—Dissenting Memo From Weiner to Ogren 713
Z. November 26, 1982—Letter From Munsell to Olsen 719
AA. December 16, 1982—Memo From Weiner to Silverstein 723
BB. February 18, 1983—Letter From Rickover to Ogren 725
CC. February 25, 1983—Ogren Memo 729
DD. May 18, 1983—Critique of the Ogren Memo 809
EE. July 8, 1983—Letter From Rickover to the Attorney General 841
FF. July 22, 1983—*Review of Navy Claims Investigations*, Office of Policy and Management Analysis, Criminal Division, U.S. Department of Justice 849
GG. August 23, 1983—Memo From Ogren to Jensen 933
HH. August 30, 1983—Jensen Declination Letter 941

EXECUTIVE SUMMARY

The history of the Newport News Shipbuilding investigation reveals inefficiencies, unexplained lapses, and systemic problems in the Justice Department's management of major defense fraud cases. The establishment of the Defense Procurement Fraud Unit (DPFU) within the Justice Department was intended to correct the type of deficiencies experienced in the Newport News case. While some progress is evident in the overall detection and prosecution of procurement fraud, systemic weaknesses continue to plague the Justice Department's efforts, especially with regard to complex cases involving major contractors.

The Justice Department's approach to the Newport News investigation was to assign responsibility for the investigation to the U.S. Attorney in Alexandria, Virginia, while retaining authority to make the final decision on whether to prosecute. Navy attorneys were assigned to the investigative team, but were given no role in decisions about investigative strategy and a minor role in determining recommendations to the U.S. Attorney. This system of dividing responsibility and authority was ultimately fatally flawed. It contributed to staffing problems, caused delays, and defeated the underlying purpose of a mixed investigative team. Instead of a combined force providing increased effectiveness, there was a divided force that proved ineffective.

The approach of DPFU has resulted in some of the same problems, including inadequate numbers of staff and excessive staff turnover. Defense Department attorneys and Justice Department civil attorneys assigned to DPFU play a minor role, primarily in the screening of referrals from Defense. The objective of establishing an effective prosecutive unit of identifiable resources available on a continuing basis to handle major defense fraud cases has still not been achieved.

Serious mistakes were made at every stage of the Newport News investigation and much time wasted during lengthy periods of inactivity. There was poor supervision of prosecutors and investigators, questionable decisions at the prosecutorial and managerial levels, excessive staff turnover, and inadequate coordination within the Justice Department and between Justice and the Navy. There is strong evidence that the statute of limitations on the substantive offenses of false claims and false statements was allowed to lapse before the case was closed.

These problems occurred even though it had been recognized at the highest levels within the Justice Department when the investigation began that prior experiences with Navy shipbuilding fraud cases were unsatisfactory and that a better approach was needed.

The following is a more detailed list of conclusions.

THE NEWPORT NEWS INVESTIGATION

1. The Justice Department allowed two years to lapse without conducting any investigation from the time allegations and evidence of possible fraud were first referred to it in 1976 by Senator William Proxmire.

2. After agreeing to share responsibility for the Newport News matter with the U.S. Attorney's Office in Alexandria, Virginia, the Justice Department failed to carry out its responsibility for advancing the investigation.

3. The head of the Richmond team did not properly carry out the directions of the U.S. Attorney to conduct further investigation following the submission of his initial recommendations in March 1980. A key witness, who was a high official of Newport News, was mistakenly given full immunity and questioned outside the presence of the grand jury, contrary to the instructions of the U.S. Attorney.

4. The U.S. Attorney's Office in Alexandria, Virginia, renewed the grand jury investigation in early 1981 and uncovered new evidence about the VCAS item. In the view of the Alexandria prosecutors, the new evidence established the methodology of how the false aspects of the claim were prepared. The prosecutors forwarded a report to the Justice Department in November 1981 concluding that there was evidence of fraud and a criminal conspiracy, and requesting staff assistance to complete the investigation. The report urged that the investigation be completed by the middle of 1982 to avoid statute of limitations problems. But from the date of the report until the case was closed in August 1983, there were no further grand jury proceedings or other efforts to advance the investigation.

5. In November 1981, Elsie Munsell, the new U.S. Attorney in Alexandria, abolished the Fraud Division in her office which had responsibility for the Newport News case, and reassigned the two prosecutors who had worked on it. This action was taken without consulting the previous U.S. Attorney or officials in the Justice Department, and over the objections of Joseph Fisher, the Alexandria prosecutor who had been in charge of the investigation. The reorganization sidetracked the investigation and reduced prospects for completing it in the U.S. Attorney's office.

6. In January 1982, U.S. Attorney Munsell asked the Justice Department to reassume responsibility for the Newport News case. Justice advised her in March that it would take back the case. The shift in responsibility for the investigation led to further discontinuity and delays.

7. The Justice Department decided to review the case to determine whether the investigation should be continued or ended. There was an additional delay and confusion in beginning the review as Justice officials searched for an attorney to work on the case.

8. Ed Weiner submitted a report on August 5, 1982, agreeing with the Alexandria prosecutors that there was evidence of fraud and a criminal conspiracy, and recommending that the investigation be continued. Later, Mr. Weiner was directed to search the files again for additional evidence of fraud. Mr. Weiner did, in fact,

uncover what he viewed as new evidence of fraud. Nevertheless, Mr. Weiner's superiors in the Fraud Section decided in November 1982 to recommend to their superiors at the Criminal Division level that the case be closed.

9. Robert Ogren, Chief of the Fraud Section, strongly argued in his report to Assistant Attorney General Jensen that by February 1983 the statute of limitations had expired on the substantive crimes of false claims and false statements. Mr. Jensen's letter informing the Navy that the dominant reason for closing the case was the absence of sufficient evidence to prove a criminal conspiracy is consistent with the view that the statute of limitations would have barred prosecution of the substantive offenses.

10. The statute of limitations would not have been a bar to prosecution on charges of conspiracy.

11. There was additional delay as the final decision by Assistant Attorney General Jensen to close the case was not made until August 1983.

THE DEFENSE PROCUREMENT FRAUD UNIT

1. The Justice Department's Defense Procurement Fraud Unit has not sufficiently corrected the numerous problems encountered with previous investigations of major shipbuilders.

2. DPFU has experienced excessive staff turnover, and effective coordination with the Defense Department still appears to be in need of improvement.

3. DPFU has produced few successful prosecutions of major contractors. As of July 1986, the Unit had participated in only three convictions of major defense contractors. In all three cases, the sentences were limited to fines.

4. DPFU appears to lack an adequate recording system for cases referred to it. According to the General Accounting Office, the Unit could not produce records showing the reasons for actions, if any, taken with regard to 58 case referrals.

I. INTRODUCTION*

Newport News Shipbuilding and Dry Dock Company, a division of Tenneco, submitted claims in March 1976 seeking $894 million reimbursement for cost overruns in the construction of 14 nuclear-powered vessels. The Navy settled the claims for $208 million and in 1978 referred the matter to the Justice Department for investigation of possible fraud. In August 1983, the Justice Department declined prosecution.

The Newport News case was controversial because it involved public allegations by high Navy officials of possible fraud by a major defense contractor, very large sums of money, and what many consider to have been an excessive amount of time to complete the investigation. The Newport News investigation also coincided with several other investigations into alleged Navy shipbuilding fraud, all of which were declined by Justice. These cases led to allegations that the Justice Department was failing to enforce the laws prohibiting fraud against major defense contractors, and that lax law enforcement was contributing to inefficiency and unnecessary cost increases in defense production.

Senator William Proxmire and Senator Charles E. Grassley conducted joint hearings of their respective Subcommittees on October 1, 1984,[1] inquiring into the Justice Department's investigation of Newport News. It was revealed at the hearings that the prosecutors in the case strenuously opposed the decision to decline prosecution. The hearings and subsequent actions by the two Subcommittees produced additional information and Justice Department documents about the investigation.

The General Accounting Office (GAO) had previously been asked to review the Justice Department's management of three investigations into alleged false shipbuilding claims, including the Newport News claims. GAO issued its report on August 1, 1985 ("Information On Three Investigations By The Department of Justice Into Navy Shipbuilding Claims," hereafter referred to as the GAO Report). The section of the report concerning Newport News, describing the dates of key Justice Department actions and decisions, and the number and experience of the staff assigned to the case, raised a number of questions about the adequacy of the management of the investigation.

Following receipt of the GAO Report, the Senators directed the staffs of the Subcommittees to conduct a detailed inquiry into the Justice Department's handling of the Newport News investigation, in particular, and of the Department's program with respect to defense procurement fraud, in general. The staff was instructed to examine the materials turned over to the Subcommittees by Justice, to obtain other materials and information, and to interview the government attorneys and officials who were involved in the Newport News investigation. The purpose of the staff effort was to provide the following:

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*This report was prepared by Richard F Kaufman and Lisa Hovelson. Frank W. Dunham, Jr., of the law firm Cohen, Gettings, Alper, and Dunham, served as a consultant.

[1] The hearings were conducted before the Subcommittee on International Trade, Finance, and Security Economics of the Joint Economic Committee, and the Subcommittee on Administrative Practice and Procedure of the Senate Committee on the Judiciary.

1. An analysis of the Justice Department's investigation of Newport News; and
2. An assessment of the approach used by the Justice Department to investigate defense procurement fraud.

In carrying out its instructions, the staff examined the available documents and records of the investigation. Unfortunately, most of the files and evidence gathered during the investigation were destroyed or returned to Newport News immediately following the decision to terminate the investigation. However, the Justice Department turned over to the Subcommittees copies of the various reports and memoranda prepared by the prosecutors and supervisors in the case. A number of documents were obtained from the Navy and additional documents were obtained from other sources including present and former government attorneys. Documents referred to as exhibits in the report are reprinted in the appendix.

The staff also conducted interviews with nearly all the prosecutors and Justice Department officials who were involved in the investigation. Most of the interviews were not recorded. However, detailed notes were taken. Summaries of the interviews were later prepared by the staff and forwarded to the persons interviewed for comment. The written summaries, comments, and letters are retained in the Subcommittee's files.

II. THE NEWPORT NEWS CASE

A. The Referrals

1. REFERRAL BY SENATOR PROXMIRE TO THE JUSTICE DEPARTMENT

In April and May 1976, Senator William Proxmire received information suggesting that the huge shipbuilding cost overrun claims filed by Newport News against the Navy were, in part, fraudulent. Senator Proxmire directed a staff inquiry and conducted hearings on the subject in June 1976 and December 1977 in the Subcommittee on Priorities and Economy in Government of the Joint Economic Committee (the hearings are entitled, *Economics of Defense Procurement: Shipbuilding Claims*).

Admiral H.G. Rickover testified at the June hearing that Newport News' claims were greatly exaggerated and unsupported, and he discussed examples from the claims that were described as "absurd." Rickover argued that the company was responsible for much of the cost overruns.

William R. Cardwell, a former long-time management employee at Newport News, also testified at the June hearing. Cardwell was a member of the shipyard's claim team engaged in preparation of the claim eventually submitted to the Navy. He testified that the claims he worked on contained exaggerated, unsupported, or inaccurate figures, and that this was done at the direction or with the knowledge of higher management.

Cardwell said that many of the construction delays and cost overruns in the construction of the ships were caused by inefficiencies in the shipyard. He testified about questionable practices including the maintenance of two sets of construction schedules. One, an optimistic schedule, showed the ships would be delivered on time, and was "published" and forwarded to the Navy. A second, more realistic schedule showed there would be substantial delays in completion of the ships. The second schedule was retained by company management and not shown to the Navy.

On July 29, 1976, Senator Proxmire wrote to Attorney General Edward H. Levi stating that he had received information in Committee hearings suggesting possible fraud by Newport News and requesting an investigation. On August 16, 1976, Justice advised Proxmire that a Fraud Section attorney had been assigned to evaluate the inquiry. (GAO Report.4)

In August 1976, Calvin Kurimai, a staff attorney in the Fraud Section of the Department of Justice's Criminal Division, opened a preliminary investigation into the question of whether the Newport News claims were based on fraud. (Exhibit L.3)[2] Kurimai was directed to monitor the Navy's analysis and technical review of the claims and report the results back to his Fraud Section supervisor.

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[2] Exhibits may be found in the appendix and are hereafter referred to as "Ex."

Kurimai kept abreast of the Navy's claim evaluation process and familiarized himself with the Newport News claims and contract procedures. (Ex. L.3) He appears to have spent an insignificant amount of time on the case. (Interview E.3)[3] When interviewed by GAO in 1985, he had no idea what portion of his time had been expended on the matter. He made no written reports or analysis of his efforts, but reported orally from time to time to the Chief and Deputy Chief of the Fraud Section regarding the Navy's progress in evaluating the Newport News claims. (GAO Report.10) A Justice Department attorney reviewing the matter serveral years later stated in a report to the Chief of the Fraud Section that the Justice Department should have begun the investigation in earnest in the summer of 1976. (Ex. W.14)

Admiral Rickover appeared before Senator Proxmire's Subcommittee again in December 1977, and testified that he had submitted to appropriate naval authorities four reports on Newport News claim items which he believed warranted investigation for possible violation of fraud or false claim statutes. Also testifying was Admiral F.F. Manganaro, Chairman of the Navy Claims Settlement Board established to examine the Newport News claim and make a formal Navy determination. At the time of Manganaro's testimony, the board had essentially completed its examination. He testified that he had notified the Navy General Counsel's office of items in the claim which he considered to be "significantly inaccurate, potentially false, or possibly fraudulent."

2. REFERRAL BY THE NAVY TO THE JUSTICE DEPARTMENT

On February 8, 1978, the Navy advised the Justice Department by telephone that it would be referring for investigation three shipbuilding claim matters from three different shipbuilders. Each involved claims which were so exaggerated that the Navy wanted the Justice Department to determine whether they were fraudulent. (Ex. G.1) One of the referrals was the Newport News case. Up to this time, Kurimai had done nothing substantive to advance the case referred by Senator Proxmire in 1976. (Int. E.3–4) The Navy indicated that it intended to advise President Carter of the referrals that day. Justice Department officials agreed, with Attorney General Griffin Bell's express approval, to begin criminal investigations.

The Chief of the Fraud Section expressed concern because the referrals failed to specify the nature and location of the suspected fraud in the voluminous claims. (GAO Report.5) The Navy believed it had specified where the suspected fraud could be found. For example, a series of memoranda from Admiral Rickover in 1977 and 1978 analyzed the possibilities of fraud in various portions of the Newport News claim. (Ex. A, B, C, D, E, and F) These analyses by the Navy were later described as excellent by prosecutors who worked on the case. (GAO Report.5 and Int. A.7)

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[3] Interviews, hereinafter referred to as "Int.," are retained in the files of the Subcommittee.

At the time of referral, Justice officials were concerned about the demands the cases would place upon the Department. Mark M. Richard, Chief of the Fraud Section, recommended that, in light of prior experience with Navy shipbuilding cases, a specialized group of defense and Justice officials take responsibility for them. John C. Keeney, Deputy Assistant Attorney General, passed the suggestion to his superior, Benjamin Civiletti, Assistant Attorney General, Criminal Division, adding that shipbuilding cases "require tremendous investigative and prosecutive resources . . . ." Civiletti passed it to Attorney General Bell who in giving his assent urged his subordinates to "Hold D.D. & Navy's feet to fire. It is their case. They must help 100%." (Ex. G.1 and H.3)

On April 18, 1978, Civiletti wrote to the Defense Department stating that the new shipbuilding cases would be handled differently than earlier ones. Civiletti explained the need for Navy legal and investigative participation in the case: "The intent is to combine multiple talents on one investigative team to conduct a more rapid and efficient investigation and, if warranted, prosecution than has been possible previously." (Ex. I.1) Richard later told GAO that Justice agreed to accept the cases because of public concern about fraudulent shipbuilding claims and a commitment by the Navy to assist in staffing the inquiry. (GAO Report.5)

The Navy assigned two attorneys from the Navy's Office of General Counsel, Eugene Paulisch and Saundra Adkins, to act as cocounsel with the Justice Department prosecutors. (Ex. L.6 and I.1–2) Adkins and Paulisch were generally familiar with procurement law and had specific experience with Navy claims. About the time that the Navy attorneys were assigned, the Fraud Section reassigned responsibility for the case from Kurimai to Joe Covington. (Ex. L.6)

3. REFERRAL BY THE JUSTICE DEPARTMENT TO THE U.S. ATTORNEY

In the summer of 1978, the Justice Department referred the Newport News matter to the U.S. Attorney for the Eastern District of Virginia, whose main office is located in Alexandria. The referral was accompanied by the services of the two Navy attorneys, Adkins and Paulisch, as well as the services of Fraud Section attorney Covington. It was the understanding of the U.S. Attorney at the time the case was referred that the responsibility for investigation and any prosecution would be shared between the U.S. Attorney and the Fraud Section. However, it was clear that ultimate decisionmaking authority in the case rested with the Justice Department. (Int. B.3, C.2, E.11, and K.3) In 1977, Attorney General Bell had personally approved the indictment of the Ingalls Shipbuilding Division of Litton Industries in Pascagoula, Mississippi, charging it with submitting a false shipbuilding claim. It was generally accepted that the Litton precedent would require Attorney General approval of any attempt to seek an indictment against Newport News. (Int. D.11)

Shortly before the assignment of Newport News to the Alexandria office, the then U.S. Attorney William B. Cummings had established a special Fraud and Corruption Division, known as the Fraud Unit. Its purpose was to concentrate resources and expertise for the handling of major defense procurement cases. Assistant U.S. Attorney Joseph Fisher was named Chief of the Fraud Unit. Elliot Norman, an Assistant U.S. Attorney, was assigned to it. (Int. B.3 and E.2)

Norman was selected by Fisher to be the prosecutor on the Newport News matter in August 1978, and the investigation was moved from Alexandria to Richmond, closer to the Newport News shipyard. (Int. C.2 and E.2) Norman had experience in handling complex civil litigation, but had no substantial experience in running major criminal investigations.

Covington, who had been assigned to the case by the Justice Department, worked on the investigation only part time. Later, a second "part-time" attorney from the Justice Department's Fraud Section, Linda Pence, was also assigned to the case. (Int. C.2, B.4, E.12–13, and L.3–4) Fisher states he had assumed at least one of Justice's Fraud Section attorneys was to have been assigned on a full-time basis to compensate for Norman's lack of criminal experience.

B. The Richmond Phase

1. THE RICHMOND INVESTIGATION AND NORMAN'S REPORT

Investigative efforts began in Alexandria in August 1978 under Norman's direction. Norman states that in the fall he and Fisher developed an investigative strategy. One decision was to conduct all substantive questioning of potential witnesses in the grand jury. Another was to conduct the grand jury in Richmond because it was the most convenient and central location for the witnesses and attorneys. (Int. E.4–5) The strategy for the investigation was to build the case step by step, concentrating on individual claim items. Norman also intended to prove an overall conspiracy by showing that false statements were submitted in individual claim items. (GAO Report.14) In the fall of 1978, Norman discussed his investigative plan with the Navy attorneys, Adkins and Paulisch. A grand jury was impaneled in Richmond on October 18. (Int. L.3)

Norman states when he first started working on the case there was a morale problem with the two Navy attorneys. They had been examining the claim and had developed a list of potentially fraudulent items, but could not investigate them and were standing idle without direction. After he, Norman, took over, the investigation progressed and the morale problem largely disappeared. In late 1979, the Navy attorneys left the case to resume their Navy duties in Washington, D.C. (Int. E.10)

Norman describes the period from October 1978 to July 1979 as an intensive investigative effort. The grand jury work was led mostly by Norman and the Navy attorneys. (Int. E.9–10) Although the district court did not allow the grand jury to sit more than one week a month on the Newport News case, Norman did not believe this hampered progress. He did not request more grand jury time because the attorneys needed the time between grand jury sessions to digest what they had learned and prepare for the next session. (Int. E.12)

Justice attorneys Pence and Covington traveled from Washington to Richmond only for the grand jury sessions and were not there between sessions. Both had other case responsibilities. Norman recalls that they remained with the investigation until it shifted to Alexandria, but neither was as active in it as Norman or the Navy attorneys. Norman states that ample resources were allocated to the case. His team included two attorneys from the Fraud Section, the two Navy attorneys, and several FBI agents and Navy auditors. (Int. E.12–13)

Navy officials have a somewhat different view of the conduct of the investigation. Paulisch suggests the Justice Department attorneys did not carry their full share of the responsibility for the investigation. Each of the attorneys was assigned to a "team" and given responsibility for portions of the claim. For example, Paulisch was assigned a 688 submarine claim and the entire aircraft carrier claim. Covington was assigned to a team but was not released from his other Justice Department duties and did not "carry the ball" on any particular claim item or aspect of the case. (Int. L.3–4)

Paulisch states that Covington's and Pence's assignment to the case overlapped for a time, but as Covington "faded out" Pence became the only Justice Department attorney involved in the investigation. Pence could not always get to Richmond because of her other cases, and eventually "she kind of faded out too." She was not responsibile for any specific part of the claim. She would appear at grand jury sessions and handle certain witnesses if she was interested in assisting on an individual claim item. According to Paulisch, Pence "played a utility role" during the period of her involvement. (Int. L.4)

Tim L. Foster, one of Admiral Rickover's former top assistants, believes that the investigation was conducted in a fragmented manner and that, if it had been better coordinated, the Navy could have made a greater contribution. (Int. N.12) Individual attorneys were given pieces of the investigation to look at, but no one seemed to have an overview. Members of the investigative team would come to Rickover's office from time to time for factual information and technical advice, but would not provide the context of the request, this limiting the assistance that might have been given. According to Foster, the Richmond team lacked supervision, direction, technical expertise, and experience. He states there was an absence of vigorous and timely follow-up to leads provided by Rickover's office at various stages of the investigation. (Int. N.18–19)

Navy attorney Paulisch has a different view that Norman's regarding the limitation on grand jury time. Paulisch states that one technique used by Newport News attorneys was to prepare witnesses friendly to its position so that they could "filibuster" with lengthy statements during their testimony. Newport News attorneys knew that the amount of grand jury time available to the prosecutors was limited. The long-winded speeches of the witnesses took up so much grand jury time that the prosecutors were unable to bring some witnesses and aspects of their case to the grand jury before the session concluded. (Int. L.6–7)

In late January 1979, the Richmond attorneys concluded that the investigation was going well and that decisions about prosecution could be made in the late spring of that year. In a July 6, 1979, letter to the U.S. Attorney, Norman said the investigative strategy was moving from review of individual claims for false statements to pursuit of evidence of a conspiracy to submit a claim regardless of the claim's validity. The letter said the task force intended to compile indictments by October 1, 1979, and that one or more individuals would be indicted on about 10 items that were submitted to the Navy with knowledge that they were false or in reckless disregard of the facts. An October 4, 1979, letter to an FBI agent states that the investigative strategy remained the same. (GAO Report. 14)

Norman said that he was optimistic about his chances of successfully prosecuting the case until November 1979, although he began having doubts about the case in the summer of 1979. His attitude began to change when Navy attorney Adkins told him that a major claim item she was investigating did not seem to be prosecutable. After he learned of negative developments on other items, he reread the grand jury transcripts and did a "total flip-flop" in his thinking. (Int. E.5–7)

One problem, Norman said, was that the prosecutors had obtained information from Admiral Rickover's staff about two of the items that turned out, after grand jury and other investigation, to be incorrect. In one instance, Norman was led to believe by a member of Admiral Rickover's staff that the claim for the Inner-Bottom Shielding of the aircraft carrier Eisenhower was false. The investigation showed the claim was not false and was "an arguably proper claim." These experiences, Norman said, added to his concern about proving a case, and the credibility of Admiral Rickover's staff. (Int. E. 7–9)

David T. Leighton, a former official in Admiral Rickover's office, said in the staff interview that he told Norman it was not true that problems in the construction of the Inner-Bottom Shielding led to delays in construction of the Eisenhower. He informed Norman that Newport News had been able to work around Inner-Bottom Shielding problems in construction of the previous aircraft carrier, the Nimitz, and he demonstrated with photographs taken during construction of the Eisenhower that the alleged delay did not occur. Leighton also points out that the Navy Claims Settlement Board concluded that the Inner-Bottom Shielding claim was without merit. (Int. L)

Leighton states that at one time he was scheduled to testify before the grand jury, but his appearance was postponed and not rescheduled. He was later given special permission by the district court to review grand jury testimony of a Newport News employee about the Inner-Bottom Shielding. He states that he showed the prosecutors that the employee's testimony was incorrect, and he gave a written memo on the subject to the Norman team. No one discussed the matter with him again. (Int. L)

Leighton states in a letter he sent to the Committee "to the best of my knowledge neither Admiral Rickover nor anyone on his staff were given a debriefing by Norman or anyone on his team as to the basis for concluding that the items raised in Admiral Rickover's letters to the Secretary of the Navy concerning possible fraud in the Newport News claims were considered invalid." (Int. L) Foster, another former aide to Admiral Rickover, said in reply to Norman's allegations that no one from the Richmond team, including Norman, had ever before mentioned to him that Rickover's office had provided incorrect information, or that it had misled or withheld facts from the investigators. (Int. N.13)

Norman recalls that in late 1979 he was "pushing" the Navy attorneys to finish their reports. (Int. E.14) About that time, he also communicated verbally to the U.S. Attorney that he would recommend against prosecution. A formal prosecutive report was submitted in March 1980 recommending that prosecution be declined.

Norman states he based his conclusions largely on the failure of the investigation to demonstrate criminal intent on the part of any Newport News official. He also found that there was no pattern of misstatements or evidence of a grand conspiracy. Factual misstatements were identified, but in general they were for items in the claim that were withdrawn prior to the settlement involving relatively small dollar amounts. Regarding the Bow Dome item, which was withdrawn from the claim, Norman stated, "The jury in any NNS prosecution will be dealing with a 'victimless' crime." (Ex. Q.46. This exhibit is Norman's prosecutive report for the Bow Dome, SSN 688 Submarine, claim item. The Bow Dome report and its attachments were part of Norman's first report and re-submitted as part of the second report, discussed below. Norman states that the Bow Dome report provides a general overview of the scope of the investigation and the prosecutive theories.)

Norman states in his report that two alternative approaches were pursued in an effort to establish that the entire claim was deliberately inflated to meet prearranged dollar targets. The first approach was to prove the company requested payment in the claims for millions of man-hours that were not worked or expected to be worked. Second, the team tried to establish a pattern of deliberate false statements in several of the small items in each of the major claims. According to Norman, both prosecution strategies failed. Newport News did not misrepresent its estimated final costs for construction of the ships, and top management did not write or rewrite the claims to fit predetermined target values. (Ex. Q.26)

Norman's report discusses the investigation of the submarine claim as an illustration of the lack of evidence of a pattern of deliberate misstatements. The report states that, of the 63 items in this part of the claim, fewer than six appeared to be factually incorrect, and these items amounted to less than 4 percent of the submarine claim. (Ex. Q.27)

However, the Richmond prosecutors had serious disagreements among themselves about important aspects of the case. For example, Navy attorney Paulisch prepared extensive written comments on Norman's prosecution report taking issue with it. Paulisch challenged Norman's conclusion that there was no pattern of deliberate misstatements in the variouis hardware items investigated. He argued that there was a pattern in the way the claims group behaved.

All the claims show a consistent pattern of overreaching, Paulisch said. The estimators had "fooled around" with their estimating calculations until they had covered all possible costs plus a substantial surplus of claimed cost. In one case, an estimator "submitted an estimate which claimed 10,000 more labor hours than the company actually booked on the whole job." The estimate on

"Navy Recruiting" shows the same disregard for actual cost. Paulisch concluded: "The claims on their face are false and/or fictitious. It appears that the claims were deliberately designed and assembled to accomplish an illegal objective, i.e., to recover more money from the Government than NNS was legally entitled to under the contracts." (Ex. N.1–4, 13)

Navy attorney Adkins wrote a separate prosecution memorandum on the Ventilation Control Air System (VCAS), a hard item claim on one of the ships. Adkins' report is heavily censored to remove material protected by grand jury rules of secrecy. What remains indicates that the investigation established the claim item was false, and that several different drafts of the VCAS claim item were under scrutiny.

The Adkins report mentions Leonard Willis, who headed the claims preparation group for the shipyard, and states, "his attorney, off the record, advised that Mr. Willis had edited the VCAS claim. Mr. Willis refused to 'lay-out' this matter for the U.S. Attorney and will answer specific questions only if given immunity from prosecution." The report goes on to discuss the role of others who worked on the claim and notes, "It is unclear why Mr. Doyle wants immunity, since he blames either Mangus or Willis for writing each claim draft." Adkins' recommendation was that Willis be granted immunity so that he could be required to "lay out" the facts. (Ex. O.25, 28, and 33)

Justice Department attorney Pence expressed her views about the Navy recruiting part of the claim, one of the soft items, in a December 1979 memo. There she states that the investigation indicated that the shipyard claimed an amount for navy recruiting "which I believe can only be categorized as outrageous." Her assessment shows that Newport News did not properly take into account the fact, among others, that historically the company has lost employees to the Navy and the Navy has lost employees to the company. But Pence concluded that the evidence developed to date would not support an indictment because of an absence of a showing of criminal intent. (Ex. M)

Pence said in the staff interview that the Navy recruiting issue, while not prosecutable, could possibly have been used as part of a "manner and means" clause in an indictment. She said the Newport News claims revealed a pattern of gross exaggeration but that it was not a sufficient basis for prosecution without evidence of concealment, false statements, or alteration or back dating of documents. Pence stated that when she left the case the Richmond team was working on three items where there was potential for finding actual false statements. However, these items alone would not make a prosecutable case because the items were for such small amounts in comparison to the entire claim. She believes Newport News abused the claims process. She said she would not assert there was no fraud, but that "we just couldn't prove it." (Int. K.6, 9, 10, and 15)

Pence said in the staff interview that, after seven months of traveling to Richmond for grand jury sessions, from a personal standpoint, she wanted out of the case. She was convinced there would be no indictment, that Norman no longer needed her, and she wanted to get back to other assignments where she could indict and try cases. Pence had no further involvement with the case after late 1979. (Int. K.12)

Norman was asked in the staff interview about the propriety of disregarding evidence of fraud in a claim against the government because the amount is small in comparison with the claim. He replied that it would not be proper, given the overall structure of the Newport News claims, for a prosecutor to dismiss a particular claim item as not relevant to a fraud case simply because it was small in dollar value when compared with the overall amount claimed. He explained that the smaller, hard items were essential to calculation of Newport News' claims on larger soft items. This was because the hard items were the base of a "multiplier effect" that was used to justify the soft items. Norman termed this the "ripple effect." However, Norman said, one or two questionable small hard items, out of hundreds, valued at less than $100,000, would not establish criminal intent if major hard items worth millions and tens of millions turned out to be legitimate claims. (Int. E.10-11)

2. REVIEW BY THE U.S. ATTORNEY AND NORMAN'S SUPPLEMENTAL REPORT

In the early part of the Richmond investigation, Norman reported orally to Fisher about once a month. In 1979, Fisher became heavily involved in the prosecution of another case and Norman did not have much contact with him during most of that year. (Int. E.5) U.S. Attorney Williams states he also received oral briefings from Norman. Both Williams and Fisher believed the investigation was going well and it would lead to indictments. They were surprised to learn that Norman wanted to close it. Norman's recommendation at the end of 1979 that the investigation be closed was viewed as a reversal of his position and shocked the Alexandria office. (Int. B.5 and I.3) Williams asked for a written report and, after a delay and several inquiries from Williams, Norman submitted his report in March 1980. (Int. I.3)

Norman states he was surprised at the reluctance of Williams and Fisher, who had not questioned his judgment on other matters, to accept his recommendation to close the Newport News investigation. (Int. E.14) He believes Fisher felt pressure from Admiral Rickover to produce an indictment and that, while Fisher also disagreed with him about the facts in the case, "his bias colored his judgment." (Int. E.21) Fisher maintains that it was Norman's reversal of position that caused him to be skeptical of Norman's recommendation.

After Norman submitted his written report, there was a March 1980 meeting at the U.S. Attorney's Office in Alexandria attended by Norman and the two Navy attorneys, Paulisch and Adkins; U.S. Attorney Williams and several assistant attorneys including Fisher and Joseph Aronica; and Justice Department attorney Pence. (Int. A.1, B.5, and I.3-4) At the start of the meeting, Pence reminded the group that there could be no final decision regarding the case without Justice Department approval. (Int. A.1)

Williams did not believe the report reflected an adequate basis for a decision to close the investigation. He recalls that the Navy attorneys implied they did not agree with Norman's conclusion, and that, while they shared some of Norman's concerns, they did not favor closing the investigation. Williams states that he asked the Navy attorneys if they agreed with Norman's assessment and they said they did not. (Int. I.4)

Williams wanted Norman to investigate further, emphasizing the VCAS claim item. Fisher recalls that the review of Norman's investigation showed that one of the Navy attorneys had found different drafts of the VCAS claim containing inconsistent contentions. One draft, which appeared factually correct, did not support any known theory of entitlement. In another draft, the facts were altered in an apparent effort to "tailor" the facts to fit an entitlement theory. The Navy attorney reported that persons involved in preparing the drafts had announced their intention to take the Fifth Amendment if called to testify about this aspect of the claim. (Int. B.5–6)

Williams directed Norman to conduct additional investigation focusing on the VCAS claim item. Williams wanted Norman to obtain formal "use" immunity for Leonard Willis, the principal Newport News claims writer, and compel his testimony on only VCAS before the grand jury. (Int. A.2 and I.4–5) Willis had previously refused to testify before the grand jury on Fifth Amendment grounds. Indeed, no one above Willis had been questioned. John Diesel, President of Newport News, had also asserted the Fifth Amendment in refusing to testify before the grand jury. Diesel was questioned informally, in the presence of his lawyer, a procedure which the Alexandria attorneys considered highly questionable. (Int. E.16) Williams was hopeful that, by granting limited immunity to Willis and limiting the scope of Willis' interrogation to the VCAS item, significant new investigative leads would develop while preserving a degree of leverage over Willis on other claim items. (Int. I.5)

Norman returned to Richmond to conduct the additional investigation. A proffer from a witness such as Willis, usually tendered by his counsel, is ordinarily essential before granting the witness immunity. Norman had obtained an "off-the-record" proffer from Willis prior to submitting his March 1980 report and he based his request to the District Court for authority to formally immunize Willis on that proffer. Willis was then immunized by the court and questioned outside of the grand jury, a method that was later criticized by Alexandria. (Int. E.14–15)

This second grand jury investigation was conducted in the spring of 1980 and completed in June. Norman submitted his report of the expanded investigation on October 1, 1980. The report consisted of a somewhat modified version of the earlier report, plus a supplemental section based on the work done at William's direction. Norman's recommendation, again, was that prosecution be declined. (Int. E.1 and Ex. R)

The first part of Norman's October report discusses the VCAS. Unfortunately, the discussion is so heavily censored that it is not possible to summarize or assess Norman's findings. In one of the few passages that remain in the copy submitted to the Committee, it is stated about the VCAS claim that "It is wrong and by 1978 everybody knew it. The staff also believes, however, that there was no deliberate effort to [passage censored by the Justice Department] at the time the claim was submitted." (Ex. R)

The remainder of the report deals with several hard claim items such as the Bow Dome, which was dealt with in the earlier report, soft items such as the aircraft carrier delays, and the issue of conspiracy to arrive at a prearranged dollar figure in the claims. In each case, Norman concluded there was no evidence of criminal intent, even though there were instances of incorrect figures or estimates that turned out to be too high. The report states that a handful of the claim items among the 300 submitted to the Navy showed a lack of attention to detail and sloppiness, indicating the claims writer was satisfied to present a colorable argument for compensation backed up by only a few of the necessary facts. But, the report states, "such evidence does not amount to proof of the requisite intent for criminal prosecution." Finally, the report found "only a few instances of factually false representations, and little or no evidence of factors conducive to a criminal conspiracy." (Ex. R.62, 63, and 64)

3. REACTIONS TO THE SUPPLEMENTAL REPORT

The second Norman report was reviewed in Alexandria by Assistant U.S. Attorneys Fisher, Aronica, and Ted Greenberg. Their conclusion was that Norman had not conducted a thorough investigation of the VCAS item, as had been requested. Eventually, when the files of the case were examined, a consensus emerged in Alexandria that the entire investigation had been mishandled in Richmond.

First, there was a realization that the Justice Department had done little to carry out its responsibility for the investigation, and that there had been serious staffing problems. The Richmond team, according to Fisher, "had more or less disappeared, not with a bang but with a whimper." Norman had given no explanation for the departures of Covington, Pence, Paulisch, and Adkins, none of whom had participated in Norman's efforts from March to October 1980. (Int. B.7)

Second, a major controversy developed over the way Willis was immunized and questioned. Williams, Fisher, and Aronica all state that Willis was questioned outside the grand jury in the presence of his attorney, and that instead of limiting the questioning to the VCAS item Norman allowed the questioning to range broadly over all claim issues. (Int. A.2–3, B.7, and I.5–6) Norman does not contest the assertion that at least part of the questioning was outside the grand jury. He states that he "may" have started the questioning in the grand jury but finished it outside because it was late in the day and the grand jury had to go home. Norman said he was not certain he questioned Willis in that manner, but agrees that if others say that was what happened, then he must have done it that way. He maintains that he did not allow Willis' attorney to be present when he questioned him on the record. Norman says he did not know that the questioning of Willis was supposed to be limited to the VCAS. (Int. E.15)

Williams contends that the effects of Norman's treatment of Willis were that the United States (*a*) had given up all leverage over Willis on other claim items and (*b*) because his testimony had not been given in a proceeding for which an oath was authorized, there was probably no foundation for a perjury charge if it was later determined that Willis had testified falsely. Williams concluded that Willis had been given total immunity, inadvertently or otherwise. (Int. I.6)

In a later review of the files of the investigation, Aronica learned about another aspect of the case that bothered him. Norman had sent letters to the targets of the investigation outlining the areas of inquiry he intended to pursue in questioning them before the grand jury. Aronica said this is not a good practice because it encourages witnesses to get together about their testimony and gives them an opportunity to fabricate explanations prior to their grand jury appearances. (Int. A.6)

When questioned about this in the staff interview, Norman explained that witnesses were initially brought before the grand jury without advance warning as to what they were to be questioned about. This caused delays as the grand jury "on one or two occasions" had to be adjourned to permit witnesses to review plans or other documents. Thereafter, some witnesses were given advance notice of expected areas of inquiry. Norman saw no advantage to be gained by keeping the pending topic of interrogation secret because Newport News had the "TARS" (Technical Advisory Reports of the Navy's Claim Review Board) and congressional testimony, which had identified the "hot" items that the investigators were interested in. (Int. E.11)

Williams also criticizes Norman's conduct of grand jury proceedings. He states that in reviewing the transcripts he found that Norman had not subjected the witnesses to the kind of hard, penetrating interrogation needed to open up a case such as this one. (Int. I.8)

A series of meetings was conducted on December 16, 19, and 22, 1980, in Alexandria to review the status of the investigation, at the end of which it was concluded that Norman had not done what he had been requested to do in March. (Int. A.3–4, B.7–8, and C.3) Fisher described the Norman efforts on the VCAS item as a "once over lightly." He said there was a "failure to interrogate everyone involved," that many Newport News officials who should have been questioned had not been, and that there was "a total absence of analysis." (Int. B.7–8) Aronica concluded that, in 11 months since Norman was directed to continue the investigation, not much had been done. (Int. A.2) After meeting with Norman on the three December dates, Williams directed Fisher, Aronica, and Norman to proceed with a thorough grand jury inquiry on the VCAS claim item to see whether the investigation should go further, and to conduct the additional effort in Alexandria. (Int. A.3 and B.8)

James J. Graham, an attorney in the Fraud Section of the Justice Department, states that he learned about the December meetings from Linda Pence, and was told by her that the Justice Department was not invited to the meetings. This added to the impression that the U.S. Attorney's office was in charge of the investigation. However, Graham says, any decision to indict or not indict would have to be made at the Justice Department, and all involved in the investigation were aware of that. (Int. C.3) Williams states that no thought was given to inviting Pence to take part in the review because at the time there was no longer any meaningful participation in the case by her or any Justice Department attorneys. (Int. I.7)

In January 1981, Fisher and Williams personally presented a detailed plan for continuing the investigation to Jo Ann Harris, then Fraud Section Chief. They also discussed the matter with Acting Assistant Attorney General John C. Keeney. Harris and Keeney approved the decision to continue the investigation. (Int. B.10)

C. The Alexandria Phase

1. THE ALEXANDRIA INVESTIGATION BY FISHER AND ARONICA

Fisher and Aronica, with the assistance of Norman, conducted several grand jury sessions in Alexandria between January and March 1981, with emphasis on the multiple drafts of the VCAS item. (Int. A.3) According to Norman, the drafts had been available to the Richmond team and there was no question about the identity of the authors—everyone knew who wrote them. Norman felt nothing new was learned in Alexandria about VCAS. Further, in his view, the broad immunity granted by Fisher and Aronica in pursuing the VCAS item precluded further persuit of that item because all leverage over the individuals involved had given away. (Int. E.18)

On the other hand, Fisher and Aronica believe that, as a result of the early 1981 grand jury sessions, they understood for the first time the "methodology" of the claim preparation, and learned the secret of how to "unravel" much of the false aspects of the claim. Aronica states that the investigation revealed how Newport News had "beat the bushes" for claim items, preparation of accounting data to support the claim, and preparation of narratives to be included in it. He says there appeared to be fraudulent statements in the narratives based on a comparison of original drafts of claim items, which has gone through a "massaging process," with the final version submitted to the Navy. (Int. A.4)

Fisher maintains that the discarded drafts contained facts which conflicted with what was submitted to the Navy, and that comments written by Newport News engineers on those drafts revealed apparent firsthand knowledge that the VCAS item was not only false, but knowingly false. He states that, while the Richmond team was aware of the drafts, they had not been analyzed for the purpose of determining whether there was a conscious effort to commit fraud. He believes this was established in the Alexandria grand jury. In addition, the authors of the drafts and most of the changes were known in Richmond, but it was not known who made a key change in the final draft. This was learned in Alexandria. (Int. B.8. For copies of the VCAS drafts, see Ex. V)

The 1981 grand jury sessions convinced the Alexandria attorneys that there was evidence upon which a jury could conclude that the VCAS item was a false claim. But to develop the facts fully and reach that conclusion, it was necessary to take 35 people before the grand jury and conduct a more detailed examination than any other claim item had been subjected to. Fisher felt that similar intensive investigation was required for other claim items to determine whether the VCAS item was part of a pattern that could justify an indictment charging conspiracy as well as substantive crimes. (Int. B.10–11)

Fisher suspected the shipyard had engaged in a conspiracy to obstruct the operations of the Navy. His theory was that Newport News wanted about $200 million more than the Navy had agreed to pay to satisfy financial requirements caused by cost overruns in the ship programs. In view of the Navy's practice of settling shipbuilding claims for a fraction of their face value, it was decided that the claim submitted would be much larger than the amount needed.

The shipyard, according to Fisher, set up a process to produce any claims which could be conjured up, for a wide variety of ships built under different contracts, without regard to merit or truth. The claims would be so staggering in size and complexity that the Navy would have difficulty analyzing them and could be pressured into making a lump sum settlement. During the negotiations over the claim, Newport News had threatened to stop building nuclear ships for the Navy unless the shipyard was fully and promptly paid. The threat to stop building ships under construction was part of the pressure. (Int. B.11–12 and Ex. V)

In the spring of 1981, the Federal District Court in Richmond considered a motion by Newport News to quash the subpoenas issued for the grand jury on the grounds that the government was harassing the shipyard. Judge Robert Mehrige ruled against Newport News but expressed concern with the length of time the investigation was taking. He commented that the staff turnover among the prosecutors had probably helped prolong the investigation, and told the government that it should complete the case within a year. (Int. A.5 and B.9)

At the conclusion of the grand jury proceedings, Aronica began a review of the files from the Richmond investigation, while Fisher became temporarily absorbed with another criminal matter. Aronica states an examination of memoranda prepared by Navy attorneys Adkins and Paulisch indicated to him that one or both believed there was evidence of a conspiracy. He selected a group of hard items for special review where the "favor" of the claims narratives was similar to the VCAS narrative, and planned to give them the same intensive scrutiny when grand jury proceedings resumed. These items included Discharge Sea Chests, Reactor Shielding, OSHA and EPA, and Navy recruiting claims. (Int. A.8)

During this period of review, Aronica concluded that there had not been enough supervision of Norman's activities in Richmond. (Int. A.5) Also, while Aronica was reviewing the Newport News files in the summer of 1981, he became aware, for the first time, of the Richmond grand jury testimony of Russell Weed and William Cardwell. (Cardwell was the witness Senator Proxmire had called to the Justice Department's attention almost five years earlier.) Aronica described their testimony as firsthand accounts that superiors at Newport News had told Cardwell and Weed to inflate claims, misrepresent facts, and include everything conceivable in the claims. He believed this was consistent with what he and Fisher were finding in the claims documents; for example, ridiculous claims, such as one for violating Parkinson's law, and factually misrepresented claims, such as the VCAS item.

2. THE FISHER-ARONICA STATUS REPORT

In the summer of 1981, Fisher and Aronica decided to summarize the status of the Newport News investigation in a report to the Justice Department before attempting to go further with the investigation. They cited several reasons for preparing the report. At the time, a new U.S. Attorney for the Alexandria office was in the process of being selected. Fisher and Aronica would have to justify the resources being used in the Newport News investigation and perhaps the need for additional resources. (Int. A.8)

A second reason was to respond to a formal and voluminous brief submitted by Newport News directly to the Justice Department, arguing that the investigation should be halted. This unusual submission by the shipyard bypassed the prosecutors in the case. Finally, the new U.S. Attorney-designate, Elsie Munsell, had indicated to Fisher during that summer that the Reagan Administration might redirect law enforcement priorities and that Navy shipbuilding cases might not be undertaken. Fisher wanted to document the justification for continuing the investigation. (Int. B. 14–15)

The Status Report was not the usual "pros memo" frequently prepared by prosecutors to help supervisors determine whether to seek an indictment. It was intended to rebut the contention that there was no case, and show that further investigation would produce sufficient additional information to warrant an indictment. To prepare the report, the Alexandria attorneys enlisted the assistance of David B. Smith, an attorney in the appellate section of the Justice Department's Criminal Division. The report does not recommend an indictment, but attempts to show that evidence of criminality was uncovered, and that further investigation would turn up evidence of more criminal violations. The report requests assistance from the Justice Department in the form of additional staffing, and states that with such help an indictment could be returned by the middle of 1982.

The report discusses evidence of "a massive conspiracy to defraud the United States," as well as evidence that several of the claim items were false. The VCAS item is analyzed at length, and copies of the various claim drafts are included in an appendix of relevant documents. It is stated that "the VCAS item is but one of many false claims knowingly submitted by NNS." Among the others discussed are Navy Recruiting, Bow Dome, Discharge Sea Chests, and Reactor Shielding. (Ex. U.6–10 and 29)

One section of the report is devoted to a rebuttal of the argument advanced in Newport News' legal brief that its requests for reimbursement are not claims within the meaning of the False Claims Act. The report shows the Act originated in congressional investigations of abusive military contracting practices during the Civil War, and quotes a 1958 Supreme Court decision holding that in passing the law "Congress wanted to stop this plundering of the public treasury." A 1968 Supreme Court decision is cited to demonstrate that the court has consistently refused to accept a rigid, restrictive reading of the Act. (Ex. U.95–101)

The report states that the statute of limitations on a prosecution for submitting a false claim would run on August 1, 1982, and on conspiracy to submit a false claim in October 1893. (Ex. U.102 and 105) The Status Report concludes by stating, "It is clear beyond cavil that the individual claims analyzed above are not only false and without legal merit, but that their preparation was purposeful and criminal," and it recommends that the investigation be concluded by late spring or early summer 1982, because of statute of limitations considerations. (Ex. U.107–109)

3. REORGANIZATION OF THE U.S. ATTORNEY'S OFFICE

Elsie Munsell began the process of reorganizing the Alexandria U.S. Attorney's office soon after being designated U.S. Attorney in the fall of 1981. Aronica states that, in a meeting with Munsell before she took office, he was asked to become Chief of the Criminal Division and she proposed eliminating the Fraud Unit headed by Fisher. Aronica says he thought elimination of the Fraud Unit was a good idea, but that Munsell had decided to do so before their meeting. (Int. A.9)

Fisher states he was called to Munsell's home and advised that she was going to eliminate the Fraud Unit and wanted him to be Chief of the Civil Division. Fisher told Munsell that he felt the reorganization would harm the Newport News investigation, and he asked her not to make a final decision until she assumed office and read the Status Report.

He states that he pointed out there was a statute of limitations problem and any interruption of current staffing on the case could impair the government's ability to conclude its investigation in time for the matter to be prosecuted successfully. He believed the best course for finishing the Newport News investigation was to devote the full-time efforts of himself and Aronica to the case. Fisher told Munsell the case was labor intensive and it would be impossible for them to work on it if given other duties. He emphasized to Munsell that there were two major defense procurement fraud cases pending in the office, Newport News and a case involving Litton, and he urged her to request a meeting with the Justice Department to get help in working these cases. (Int. B.14–17)

Munsell said she eliminated Fisher's unit because it was too narrow in scope to handle all the significant cases assigned to her district. She states the decision to eliminate the Fraud Unit was independent of consideration of any case pending in the district, and that she made no inquiry to determine what effect it might have on any particular case. She made the decision without consulting her superiors in the Justice Department, and without discussing it with her predecessor, Williams. (Int. D.3)

Munsell said she did not know then, and did not know at the time of the staff interview, whether Aronica and Fisher had been actively engaged in conducting the Newport News investigation before she took office. She believed their interest at the time she became U.S. Attorney was limited to the preparation of the Status Report. She said she had no reason to consider the effect of their reassignment on the investigation. (Int. D.4)

Munsell read the Status Report shortly after taking office in November 1981. Her review showed there was evidence of criminal wrongdoing and her main concern was to assure that the matter received appropriate staffing. (Int. D.5) It was the view of Munsell and Aronica, contrary to Fisher's view, that Fisher and Aronica could continue to work on Newport News even though limited to part-time effort by their new supervisory roles. Nevertheless, all three attorneys concluded that at least two additional full-time prosecutors would be needed to complete the investigation. (Int. A.10, 16 and B.16)

Munsell states it was her impression that Aronica and Fisher wanted to keep the Newport News case in the U.S. Attorney's office and work on it. But she concluded that because of staffing problems her office could not work on both shipbuilding cases and one of them would have to be handled by the Justice Department. In response to a question during the staff interview, she gave no explanation as to why she did not consider the option of obtaining additional staff from the Justice Department instead of seeking to have one of the cases reassigned to Justice. She said her only concern was that both matters receive appropriate attention. (Int. D.5–6)

From the time Munsell's reorganization took effect until early January when she and Aronica decided to ask the Justice Department for assistance, no work was done on the case by Aronica or Fisher, both having been given new administrative duties.

D. THE JUSTICE DEPARTMENT PHASE

1. THE JUSTICE DEPARTMENT REASSUMES RESPONSIBILITY

At Munsell's request, a meeting took place with Justice Department officials in January 1982 to discuss the two shipbuilding cases. Present at the meeting from the Alexandria office were Munsell, Fisher, and Aronica; and from Justice, Lowell Jensen, the Assistant Attorney General for the Criminal Division, his Deputy, Roger Olsen, and James J. Graham, then Acting Chief of Justice's Fraud Section. Munsell says she made it clear at the meeting that she wanted the Justice Department to take one of the cases and that she expressed no preference as to which one. She states Justice had some responsibility for the shipbuilding cases because of the way they were referred and the understanding that there would be sufficient assistance from Justice. (Int. D.6–7) Fisher and Aronica agree it was proposed at the meeting that Justice take over one of the cases. (Int. B.17 and A.10)

But Graham states he was shocked to learn at the meeting that Munsell wanted Justice to take over both cases on grounds that she was reorganizing her office. He was surprised at her proposal in view of the size and age of the two investigations. Both would be "tough nuts" to crack and it seemed inappropriate for the U.S. Attorney to be trying to hand them over to the Justice Department. Graham says he thought at the time "if the cases were important, why should a reorganization prevent them from being properly staffed?" (Int. C.5–6)

Jensen's and Olsen's recollections of the meeting are similar to Graham's. Both agree Munsell said she did not have the resources to handle the two cases. According to Jensen, the major problem was that the attorneys who had worked on Newport News during the past year were no longer available due to the reorganization; they were in supervisory positions and unable to do further investigation. The final conclusion, Jensen said, was that Fisher and Aronica were "totally unavailable" and new people were needed for the Newport News case. (Int. M.2) Olsen recalls Munsell wanted the Justice Department to take over both shipbuilding cases, but she was stronger in her desire that Newport News be taken by Justice than that Litton be taken. He states Munsell's attitude was "we want to give Newport News back to you." Olsen states that during the meeting he and Jensen were trying to figure out exactly why Alexandria could not handle the cases. (Int. G.3–4)

After the meeting with Munsell, the Justice officials met among themselves and decided Alexandria should keep the Litton case because it was under indictment, and Justice would take over Newport News. The option of sending people from Justice to help Alexandria with Newport News was discussed. That option did not seem feasible because Fisher and Aronica would not be available to work on the case full time as a result of the reorganization. Jensen said, if Munsell had indicated Fisher and Aronica were available to work on Newport News and she needed some help for them, he would have considered that approach. (Int. C.6, G.4–6, and M.3)

Weeks went by before Alexandria heard from Justice about its decision. Munsell finally received a telephone call from Olsen on March 11 advising her the Justice Department would assume full responsibility for the Newport News matter. She confirmed the arrangement by a letter to Jensen dated March 26, 1982, stating Roger Olsen told her on March 11 that the Criminal Division accepted full responsibility for the Newport News investigation. (Int. D.6)

In the months that followed, Munsell received no progress reports from the Justice Department on the case. She states no arrangements had been made for progress reports and no one in her office had any responsibility for the matter. If she had thought her office had any responsibility, she would have inquired about the status of the case. (Int. D.8) However, in November 1982, Munsell wrote to Roger Olsen seeking information about the investigation and stating, "As far as I know, only one lawyer is assigned to the case, and one FBI agent. All of the documents are here, but we see no concerted activity by people using them." (Ex. Z.1)

2. THE ASSIGNMENT OF ED WEINER

Olsen states Justice needed to make its own assessment as to whether it should go forward with the Newport News investigation without being bound by the Fisher-Aronica Status Report. It was decided the Fraud Section would review the entire investigation and not be constrained by the recommendation of the Alexandria prosecutors. (Int. G.7–8) Graham, Acting Chief of the Fraud Section, states he read the Status Report and thought it presented an interesting approach to the possible prosecution of Newport News. If it could be shown there were other examples like the VCAS item, with multiple drafts of the claim demonstrating fraud, there would be real progress in the investigation. (Int. C.4)

Graham and Olsen felt the case required at least two attorneys on a full-time basis, because of its complexity. Both felt an experienced, senior litigator should head up the review. Olsen said he "wouldn't assign a junior lawyer to something like this." Graham reviewed the availability of attorneys in the Fraud Section and found they were all busy with other assignments. Graham decided to assign Ed Weiner, who was in the process of winding up his responsibilities in the Economic Crime Program.

Graham also wanted William Lynch, a Justice Department senior litigator, to be assigned to the case to work with Weiner. Graham recommended to Olsen that Lynch be recruited and he directed Ed Weiner to go to Munsell's offices to review the Newport News files while awaiting the decision about Lynch. Olsen said he did talk to Lynch about working on Newport News, but could not recall Lynch's reaction or why Lynch was not assigned. In March, when it became apparent that Lynch would not be assigned, Graham directed Weiner to get going on the case himself, but he continued to hope a second attorney would be assigned. Graham acknowledges that the case was not adequately staffed from March 1982 to August 1982. (Int. C.7–9, G.8, and GAO Report.7)

Graham states that Weiner's instructions were to find out everything he could about the case and to come up with an investigative strategy, keeping in mind that he had the options of continuing the investigation, ending it, or recommending indictment. He also had authority to talk to witnesses. From March to August 1982, Weiner came under Graham's supervision. However, Graham states he was never intensively involved in the case and did no official monitoring of Weiner's activities.

In March 1982, Robert Ogren was appointed Chief of the Fraud Section, and Graham resumed his role as Deputy Chief. Olsen recalls talking to Ogren about Newport News "shortly if not immediately upon" Ogren being hired, and says he made it clear to him that he expected to be kept advised of its progress. Olsen says he had ongoing discussions with Ogren about Newport News during the March–July 1982 period. (Int. G.11)

Weiner states his first contact with Ogren was in July 1982 when he was asked by Ogren to be brought up to date on Newport News. He advised Ogren and Graham at that time that he was going to recommend additional manpower be put on the case and additional investigative work be done. (Int. H.6)

Ogren disagrees with the recollections of Olsen and Weiner. He states he first became aware of Weiner's role in reviewing the Newport News case in about March 1982, when he assumed his position as Chief of the Fraud Section. When he learned about it he was told, probably by Graham, that Bill Lynch would be asked to work on it with Weiner. He states he learned from Graham the case was initially a Criminal Division matter. It became the responsibility of the Fraud Section when it was determined Lynch would not be assigned to it. According to Ogren, as late as August 1982, he did not understand the Newport News case and did not clearly understand the role of the Justice Department's Criminal Division or of his Fraud Section with regard to it. He states the first time he knew anything about the Newport News matter was in August 1982. Prior to that time, he had "given no thought whatsoever" to what Weiner was doing. (Int. F.2–3 and 6)

3. WEINER'S REVIEW AND REPORT

Weiner began his detailed review in April 1982, and he spent the next several months going over the record of the investigation. He examined grand jury transcripts, documents, FBI reports, the reports prepared by the various prosecutors, depositions in a related civil case, and pertinent congressional hearings. He discussed the case with the Alexandria and Richmond prosecutors and the Navy attorneys, and interviewed Navy engineers and grand jury witnesses. During the review, he received a telephone call from Newport News attorney J. Clayton Undercofler, in which it was suggested that Weiner conduct off-the-record interviews with shipyard officials. Weiner said he wanted to interview the officials without such restrictions, but this request was rejected. (Int. H.7, 9, and 10)

Weiner submitted his written report on August 5, 1982, recommending that active investigation should be resumed and "should focus on the NNS claim effort as a conspiracy to obstruct, impede, and delay the lawful function of government . . . and the orderly claims processes. . . ." (Ex. W.18) His general impression was that the Richmond phase of the investigation had covered a lot of ground but spread itself too thinly and had not concentrated sufficiently on any particular aspect of the claim. While this permitted the Richmond team to get a good global view, there was a lack of intensive follow-up on items that appeared questionable. But he believed the case was not in bad shape because of the work done in both Richmond and Alexandria. (Int. H.4)

His report states there is sufficient evidence to prove the VCAS claim is fraudulent, and that additional investigation is indicated for two other hardware items, Discharge Sea Chests and Reactor Shielding. Concerning the soft claim items, the report concludes the Deterioration of Labor (Parkinson's Law) claim is "outrageous and fraudulent," the Navy Recruiting Practices claim "is ridiculous," and further investigation is needed with regard to several other alleged delays and disruptions. (Ex. W.3–6)

In addition to fraud in the claim items, Weiner concluded there was evidence of a conspiracy. His report states, "I believe that a sophisticated conspiracy to inflate claims regarding cost overruns was begun by Newport News late in the summer of 1974." After noting that "some work" had been done on this aspect of the case by the Richmond and Alexandria prosecutors, he observed "it may be too late at this point (eight years after the fact) to prove the conspiracy beyond a reasonable doubt." (Ex. W.7) In Weiner's view, "The Department of Justice should have begun this investigation in earnest in the summer of 1976." (Ex. W.14)

Weiner's theory is similar to what is described in the Fisher-Aronica Status Report. He believes the strategy was to recover $200 million from the Navy by claiming four or five times that amount. A claims process was established which would lead to exorbitant claims. Employees who had no previous experience in claims came up with unbelievable estimates of delay, disruption, and deterioration of labor in order to create a massive amount of paper which the Navy might not be able to digest. Pressure tactics, such as the threat to stop construction of Navy ships, were employed to force a favorable settlement. (Ex. W.16)

In the staff interview, Weiner provided additional details about the conspiracy theory. He referred to the "moon/Swiss cheese" memo, a document obtained from Newport News by subpoena. The memo was intended to guide shipyard claims writers. It told the claims writers that it is permissible to ask for the moon if it is made clear that the writer believes it is made of Swiss cheese. The making of outrageous claims based on equally outrageous entitlement theories was encouraged and employees were advised that this would not be fraud as long as the facts were not knowingly misstated. (Int. H.17)

Weiner also discussed the testimony of William Cardwell and Russell Weed, the former shipyard employees. He states Cardwell testified he had been asked to inflate claim items by four or five times, and Weed had evidence of a plan to inflate the claims. Although Weed had left Newport News before the claims were submitted, he was working at the shipyard when the plan to submit them was "hatched." Weiner states he found evidence of conversations between Leonard Willis, the head of the claims group, and a Navy official in which Willis was reported to have said that the shipyard would ask for $600 million but wanted only $200 million. Weiner says he had reservations about the dependability of testimony from Cardwell and Weed because of memory lapses since the events they witnessed. (Int. H.18)

4. THE FRAUD SECTION'S REACTION AND WEINER'S FOLLOW-UP EFFORTS

Weiner received no reaction to the report for several weeks after it was submitted, except for a comment from Graham who thought it was interesting. (Int. H.10) Olsen believes he began discussing it with Ogren in late August or early September. Olsen states the dispute about whether to continue the investigation centered on the viability of a prosecutive theory. No one disagreed about what the evidence was. (Int. G.12)

Ogren does not recall reacting to the report until after he hired Morris Silverstein to work in the Fraud Section in late August 1982. Silverstein was made head of a litigation branch within the Fraud Section in early September. About this time, Weiner was assigned to work under Silverstein and, according to Ogren, the Newport News case "became a Fraud Section matter by default." (Int. F.4) Silverstein first discussed the report with Weiner in early September. (Int. H.11)

On September 17, Ogren and Silverstein asked Weiner to prepare a "work plan" to continue the investigation for a 60-day period. Weiner submitted his work plan on September 24. The plan was primarily directed toward investigation of conspiracy. After he submitted his work plan, Weiner was then directed to concentrate on the hardware items, like the VCAS, to see if there was a pattern, and to ignore the soft items and the conspiracy. (Int. H.11–12, F.8 and Ex. Y.1)

Sometime during the next two weeks, Silverstein told Ogren, based on his reading of the prosecutors' and the shipyard's summaries of the case and a discussion with Fisher, that his initial impression was that "despite everything that has gone on in the investigation, we don't have anything." At about this time, Weiner was directed to look for documents concerning the statute of limitations. Silverstein states he was then focusing on the case and under one theory the statute of limitations would run in six or seven months. In the weeks that followed, Silverstein's doubts about the case increased. (Int. J.35-36 and 41-42)

In response to the directive to come up with additional hardware items, Weiner examined the claim narratives for the Discharge Sea Chests and Reactor Shielding portions of the claim. In mid-October, Weiner found a box in the basement of the U.S. Attorney's Office containing drafts of those claim items in spiral-bound notebooks. The handwritten drafts, when compared with the narratives in the claim submitted by Newport News to the Navy, showed that the facts in the claim were different than and inconsistent with those set forth in the handwritten drafts. (Int. H.12-13)

Weiner recognized that the methodology of claim preparation had been established during the investigation of the VCAS item by Fisher and Aronica. Claim items were drafted initially by production workers who had firsthand knowledge of what happened during construction but had little or no knowledge of claim entitlement theory. The items were later revised for claim purposes by the Contract Control Group who had no knowledge of what had happened except what was described by the production workers. But the Contract Control Group was well aware of what a description of facts would have to contain in order to support a legal entitlement theory. Weiner believed he had evidence that the handwritten claim drafts on Discharge Sea Chests and Reactor Shielding, like the handwritten drafts on VCAS, were accurate factually but were later altered by the Contract Control Group to fit an acceptable entitlement theory. In the process, a true statement not supporting a legal claim of entitlement was converted into a false statement supporting a false claim. (Int. H.13)

Weiner said he was excited by what he had found. Norman had told him during his first review that the VCAS item was clearly false, but it was unlikely a conviction could be obtained on that item alone. Norman stated that if he had two or three other items like the VCAS, he would have felt there was a pattern and the case could go forward. (Int. E.19) Ogren and Silverstein had directed Weiner to examine other hardware items to see if there was a pattern. Weiner believed he found evidence of a pattern, although he realized that additional investigation was required. He pointed this out to Ogren and Silverstein on October 20, and demonstrated the similarity between these items and what had been found with regard to the VCAS item. (Int. H.13-14)

5. OGREN AND SILVERSTEIN DISAGREE WITH WEINER AND WEINER DISSENTS

Silverstein states that, although he did not spend every day on Newport News, he "focused on the case from the time that Weiner was assigned [to him] . . . it was a big case [and] the statute of limitations under one theory . . . would run in another six or seven months." (Int. J.36 and 41) Silverstein did not become skeptical about the case until after Weiner submitted his plan to revitalize the investigation on September 24, 1982. (Int. J.39) This skepticism bloomed into "real doubt" about the case during the first two weeks of October. (Int. J.42) Sometime between September 24 and the first two weeks of October 1982, Silverstein spent two afternoons at the U.S. Attorney's Office in Alexandria. (Int. J.42) Silverstein states his doubts arose in a brief conversation with Fisher during one of his visits to Alexandria. Silverstein says Fisher claimed that the creation by Newport News of the Contract Control Group was criminal. Silverstein believed the creation of this control department was a neutral act. (Int. J.36-37)

Weiner, Ogren, and Silverstein had a series of meetings about the Newport News matter on October 12 and 20, and November 3 and 9, 1982. (Int. H.14) Ogren states he and Silverstein spent about 10 hours in this review of the case with Weiner. (Ogren letter of March 6, 1986, p. 3, which is part of Exhibit U) Weiner thought Ogren and Silverstein would be impressed with the additional hard items he found. But Ogren did not agree that what Weiner found was the major evidentiary breakthrough Weiner thought it was. While Weiner felt grand jury inquiry would be necessary before any final conclusions could be reached with regard to the multiple drafts on the claim items he discovered, he believed they were truly similar in nature with what Fisher and Aronica had found on the VCAS item. (Int. H.14)

Silverstein acknowledged Weiner did find two other items with multiple drafts, but said he still saw problems with the case. (Int. J.81) He had problems with the VCAS item because he did not believe it had been established who had authored the drafts. (Int. J.77-78 and 80) Concerning the two other items that Weiner uncovered, he said he "didn't see . . . the same sort of thing we found in the ventilation air control." (Int. J.81)

During the meetings, it became apparent to Weiner that Ogren was going to recommend declining further investigation of the case. (Int. H.14 and Ex. Y.1) Ogren told Weiner that central to his decision to recommend closing the case was his reluctance to commit additional manpower to the investigation. (Int. H.14) According to Weiner, Ogren justified this position by pointing out (*a*) he would have to pull people off other cases in order to staff the Newport News case adequately; (*b*) delay in reaching a conclusion on the investigation which had come to the Justice Department in 1978 and statute of limitation problems made it perhaps not fruitful to pursue the matter further; and (*c*) he was uncertain of Weiner's theory of the case. (Int. H.14-15) According to Weiner, Ogren further said the matter was "too old" and there was no proof of deception. (Int. H.14, 20, and Ex. Y.1)

Ogren's concern, Weiner said, about the conspiracy theory of the prosecution had to do with the case of *U.S.* v. *Hammerschmidt,* 265 U.S. 182, 188 (1924). Ogren believed, before a conspiracy to obstruct the Navy claims settlement process could be proven, the government would be required to show there had been some degree of trickery or deceit on the part of Newport News. (Int. H.15)

Weiner did not believe such an element of proof was required. (Int. H.15) Weiner felt that piling reams of material upon the Navy to bog down the process—including placing the requirement on the Navy to wade through encyclopedia-like voluminous material to ferret out and unscramble claim narratives that left out facts, misstated facts, and created misleading innuendos—provided ample basis for proving a case for submission of a deliberate false claim, particularly when coupled with the evidence that the shipyard went into the claims process with the intent of asking for more money than it actually had hoped to realize and then tried to force a settlement by threatening to stop building ships. (Int. H.21) In addition, Weiner did not accept Ogren's view that there was no deception. (Int. H.15) In Weiner's judgment, examination of the early drafts of the hard claim item narratives revealed them to be sufficiently deceptive to support a prosecution. (Int. H.15 and 21)

When Ogren said the matter was too old, Weiner understood him to be referring to the investigation which had been done by others prior to the time the Justice Department's Fraud Section took sole responsibility for the matter. (Int. H.20) Ogren was apparently concerned about trying to refresh the recollection of witnesses regarding old events and going back and reinterviewing witnesses that had already given statements to the FBI or had been questioned extensively in the grand jury. Weiner states Ogren was also concerned about the number of stops and starts in the matter—something that Ogren felt was unusual in Justice Department investigations and believed would cause problems if the Justice Department tried to start the investigation yet one more time. (Int. H.20-21) Weiner's view was the case was not too old as long as the statute of limitations had not run. (Int. H.20)

According to Weiner, Silverstein repeatedly stated "materiality" was an element of a False Claims Act case, and that Silverstein had a problem with the "materiality" of the Newport News representations Weiner viewed as fraudulent. (Int. H.18) Weiner understood Silverstein's materiality concerns to stem from the fact the individual claim items that appeared to have the most prosecutive merit were small in dollar value when compared with the overall magnitude of the Newport News claim. (Int. H.19-20) In Silverstein's view, this undercut proof of intent to defraud. (Int. H.20) Silverstein suggested during the staff interview, however, that the materiality proof problem related to the fact the Navy had already denied certain Newport News contentions before they were submitted in the claim. Silverstein said even if a claim was false it would not be material because Newport News had obviously submitted the claim knowing the Navy would not believe it. (Int. J.44-49)

Silverstein also seemed to equate "materiality" with "reliance," implying someone would have to show the Navy relied on a falsehood to its detriment in order to successfully bring a False Claims Act case. (Int. J.47) Silverstein agreed during the staff interview that, in the Fourth Circuit, where any case against Newport News would be brought, materiality was not an element the government would have to prove in a False Claims Act case. (Int. J.47) Silverstein said, even if materiality were not an element, the problems he categorized as materiality problems would make it difficult to establish intent. (Int. J.51-52) Weiner believed the dollar amounts of the items could not be viewed as immaterial because they were at least six figure amounts, large claims against the government by almost any standard of measure.

Weiner asked permission at the November 9 meeting with Ogren and Silverstein to put his disagreement with their decision to recommend declining prosecution in writing and was advised he could do so. On November 17, Weiner wrote a "dissenting memorandum," stating his conviction that further investigation would enable the government to prove there had been a conspiracy to obstruct, impede, impair, and overload the Navy claims evaluation process with the objective of getting paid more than Newport News was entitled to receive. (Int. G.13, H.15, and Ex. Y)

6. THE OGREN REPORT

On November 29, 1982, Weiner was asked to obtain certain files from Alexandria to be used by Ogren in preparing a report to Assistant Attorney General Lowell Jensen. Weiner delivered the files to Ogren on December 16, 1982. By that date, to Weiner's knowledge, Ogren had not yet reviewed the files or any source material in the case, and Silverstein had spent one or two days examining source material in Alexandria in late October. (Int. H.19) Ogren states in his report that he met with Weiner and Silverstein on a number of occasions to review the progress of the evaluation and reviewed a number of transcripts, documents, and other materials. (Ex. CC.2)

On February 25, 1983, Ogren sent his report to Jensen recommending prosecution be declined and the investigation be terminated. Silverstein drafted part of it and Graham was also given a copy. It had not been shown to Weiner or the prosecutors in Alexandria. In the staff interview, Ogren said he saw no reason to show it to Weiner because he had already registered his disagreement with Ogren's position. (Int. F.14) The memo was not shown to the Alexandria office until April 1983. (Int. F)

The report analyzes the two types of offenses identified by Weiner and the Alexandria prosecutors: (1) the substantive crimes of false claims and false statements, and (2) conspiracy. It acknowledges that four of the hard claim items examined, including VCAS, the Discharge Sea Chest, and Reactor Shielding, and OSHA and EPA, "appear to contain false claims or false statements." But the memo states, none are prosecutable because there are adequate legal defenses. Concerning the conspiracy to defraud theory, Ogren concludes its use would be impossible. (Ex. CC.2)

Among the defenses against prosecution for false claims or false statements, the report cites the likelihood that the statute of limitations had already run; the fact that after five years of investigation only four items totaling a few million dollars out of a $894 million request were shown to be arguably false, one of which was withdrawn by Newport News prior to settlement and the others subject to technical attack; and it would be difficult to prove there was specific intent to defraud the government. The amounts of the false claim items are listed as follows: VCAS, $930,000; Discharge Sea Chest, $300,000; Reactor Shielding, $384,000; and OSHA and EPA, $5.5 million. (Ex. CC.19-29)

The intent requirement cannot be satisfied, the report states, because under the law the government must prove that the person submitting the false claim knows it is false and is aware he is violating the law. Proof of reckless indifference or disregard as to the truth or falsity of a statement is not enough. Ogren concludes no evidence had been developed pointing to a specific high level official of Newport News who had the necessary specific intent to submit false claims.

The report states an indictment for conspiracy would not hold up for a number of reasons. Two kinds of conspiracies were discussed by the prosecutors, conspiracy to file false claims, and conspiracy to submit voluminous meritless claims. Ogren's view is the government would not be able to sustain a charge of conspiracy to file false claims because "it is not possible to prove any substantial portion of the various claims to be false." The four claim items represent less than 1 percent of the total claim, and even with respect to these there is no evidence of intent or linking the falsity in those items to a conspiracy, according to the memo. (Ex. CC.12–15)

The second conspiracy theory was that Newport News submitted voluminous, meritless claims in an effort to break down the Navy's claims process. Ogren concludes the theory would not hold up because there is little evidence to support it and abundant evidence to contradict it. In addition there is no precedent for a charge of conspiracy to defraud the United States by impeding and impairing its lawful functions unless there is a component of deception or trickery. Citing the 1924 Supreme Court case of *Hammerschmidt* v. *United States* in support of the idea that the government must prove deception or trickery, the memo concludes that as to virtually all of the soft claim items the issue is not nondisclosure or deceit but entitlement. (Ex. CC.15–18)

Ogren said in the staff interview that, when deciding whether to recommend the investigation be continued, the question in his mind was "will it be productive?" There were too many problems with the case which made it, in Ogren's judgment, not worth the effort. A major factor in his decision was that it was "very late in the game." If it had been a new matter, he might have felt differently because age is definitely a factor which usually mitigated against a successful prosecution. (Int. F.11)

7. CRITIQUE OF THE OGREN REPORT

The U.S. Attorney's Office in Alexandria did not receive a copy of the Ogren report until April 1983. In response, the Alexandria attorneys prepared a "Critique of the Fraud Section Memo" which was forwarded to Assistant Attorney General Jensen on May 18, 1983. The Critique, signed by U.S. Attorney Munsell, Aronica, Fisher, and Smith, replies to the arguments against prosecution, except for those related to the statute of limitations problem with respect to the substantive offenses. It says, "We are still convinced that there is a prosecutable case against the company," and suggests that a two-count indictment charging conspiracy to defraud the government and to impede and impair its lawful functions could be quickly drafted. (Ex. DD.2)

The Critique argues that Ogren is wrong to conclude there is little, if any, evidence of actual fraud. In addition to the evidence of fraud in the VCAS and soft items found during the U.S. Attorney's investigation, it is pointed out that Weiner was able to uncover new evidence of fraud in two other hardware items in a relatively short period just by taking the time to read a few of the documents. The company's claim, the Critique states, "is like a huge field of oil lying just beneath the surface of the earth. Wherever prosecutors probed, oil (evidence of fraud) bubbled to the surface." (Ex. DD.6-9)

Ogren's assertion, the Critique states, that there is no evidence of specific intent even with respect to the four false claim items, completely misperceives the law on specific intent. The Alexandria attorneys state it is not necessary to produce a confession of company officials to satisfy the intent requirement. Ordinarily, intent is not proved directly because there is no way to fathom the operations of the human mind. Intent is usually inferred from the surrounding circumstances. If a claim is false, it may be inferred that the person who submitted it intended to submit a false claim. It may also be inferred that the claim was submitted with reckless indifference to whether it was true or false. (Ex. DD.11-14)

According to the Critique, the authors of the false claims, including the VCAS, are known to the prosecutors, contrary to the assertion in the Ogren report. More importantly, a corporation is criminally liable for the acts of its employees, and it is not necessary to establish links between high level officials and particular claim items. It would be enough for the government to prove that whoever wrote a particular claim must have known it was false. (Ex. DD.22-24)

Ogren's report states a prosecution of the Discharge Sea Chests claim would fail because the government could not satisfy the materiality requirement. It also states an indictment for the Reactor Shielding claim would fail partly because the amount of the claim is comparatively insignificant, and that the VCAS claim is at best a technical violation because it was withdrawn prior to settlement. Both Ogren and Silverstein raised the issue of materiality in the staff interviews, and indicated that obtaining a conviction in a false claim or false statement case is almost impossible unless the government can show it relied on the claim or statement, or was induced by it to spend a relatively significant sum of money. (Int. F.12 and J.44-52)

These views are disputed by the Critique which maintains it is well settled that materiality hinges on whether the false statement has a natural tendency to influence, or was capable of influencing, the determination required to be made. A false statement may be material although the government does not actually rely on it, or if it is ignored or never read. It is a crime to submit a false statement that is merely capable of impairing the functioning of a government agency. (Ex. DD.25-26)

The Critique points out that, in addition to the fact the four hardware items "recognized as false" add up to about $7 million, the soft claim items questioned are much larger. These include the Deterioration of Labor/Parkinson's Law ($97 million) and Navy Recruiting ($24 million). (Ex. DD.3 and 10)

The materiality issue also was discussed in the staff interview with Roger Olsen, who at the time of the interview was Acting Assistant Attorney General for the Tax Division. Olsen was asked about the argument that a particular claim item might not be "material" because it represents a relatively small portion of the overall claim. He replied by referring to a recent tax case in which a large firm was indicted for making a $96,000 false statement on its tax return. The firm argued its income was so large that the error resulting from the false statement was equivalent to an average taxpayer making a $0.38 false statement. Olsen said the firm was prosecuted successfully despite the fact that the false statement had very little effect on its overall tax liability. (Int. G.20-21)

8. THE STATUTE OF LIMITATIONS PROBLEM

The statute of limitations problem began to be discussed in 1981. Fisher and Aronica expressed deep concern about it in their 1981 Status Report. Olsen, who served as Lowell Jensen's deputy, states that throughout the time he was involved in the case there were always discussions concerning the statute of limitations. (Int. G.9)

The application of the statute differs somewhat with respect to substantive offenses and conspiracy. Newport News filed its revised claim on March 8, 1976. Normally, criminal prosecutions for false claims are barred unless indictments are brought within five years of the submission of the claims. However, conspiracy is a continuing offense, and all government attorneys seemed to agree the statute of limitations on a conspiracy prosecution would not run until October 5, 1983, five years after the Navy and Newport News reached a settlement on the Newport News claim.

In addition, the statute may run anew on substantive crimes under certain circumstances. The Alexandria prosecutors determined that a Newport News letter of August 1, 1977, informing the Navy of changes in the projected costs of the ships for which claims had been submitted, had the effect of starting anew the running of the statute of limitations. In other words, the government had until August 1, 1982, to bring an indictment. This explains why Fisher and Aronica say in the Status Report, "Statute of limitations considerations make it advisable that the investigation be concluded by late spring or early summer 1982." (Ex. U.102-106 and 108)

The Ogren Report discusses the question of whether there is a claim or statement within the statute of limitations. By the time of the report (February 1983), the date identified by Fisher and Aronica had passed, beyond which prosecution of the substantive violations would be barred. However, several letters sent by Newport News to the Navy in 1978 concerning the settlement negotiations had been found. Ogren explored the possibility that these letters renewed the claims and are themselves false claims or false statements. Regarding the possible renewal of the claim, the report states, "we doubt that a court would allow the Government to revive an otherwise time barred claim for statute of limitations purposes each time a new letter is submitted to the Navy prior to obtaining payment."

The Ogren Report discusses whether the letters, one dated April 20, 1978, and several dated October 5, 1978, are claims or statements. It points out that one of them states that no major errors or inconsistencies had been found in the claims, and the others state that no inaccuracy had been found during the negotiations, and wherever an inaccuracy could have affected pricing, the company advised the Navy. Ogren concludes, "It is doubtful whether these assertions could be called 'claims'."

The report goes on to state that the assertions in the letters are statements which, if false, could be potentially prosecuted. But the assertions about errors, inconsistencies, and inaccuracies were general. Ogren concluded that attempting to build a prosecutable case from such general, nonspecific statements would be a formidable task, and in the context of the proof problems in the Newport News case "it appears insurmountable." (Ex. CC.19–21)

Ogren said in the staff interview that there were statute of limitation problems with regard to a prosecution for false claims, but none with regard to a prosecution for false statements. In a subsequent letter to the Committee, he states, "I believed then and now that the statute of limitations issue was totally secondary." (Int. F) Silverstein maintained during the staff interview that "the statute of limitations was never an issue in declining on Newport News." He referred specifically to October 5, 1978, letters from Newport News saying they extended the statute of limitations five years from that date. (Int. J.75)

9. THE DECISION TO CLOSE THE INVESTIGATION

In August 1983, a meeting was held by Assistant Attorney General Jensen to decide whether or not to proceed with further efforts on the Newport News matter. Jensen does not recall why the meeting was not held sooner. He states that he assumes there were schedule problems on both sides, and there may have been an earlier date set for the meeting that was canceled. Attending the meeting were Fisher, Munsell, Aronica, Silverstein, Olsen, Ogren, Jensen, and Keeney. (Int. B.21, G.16, and M.6) By the time of the meeting, Ogren had responded to the Alexandria Critique of May 18 with a memo dated August 23, 1983. In it, he repeated his recommendation that the investigation be terminated. (Ex. GG)

"We were asking," according to Attorney General Jensen, "can we file [an indictment] now or, if not, what would it take to get there." (Int. M.6) Fisher and Aronica responded that it was too late for the kind of indictment they had contemplated when the Status Report was prepared because, by the end of 1982, the statute of limitations had run on the substantive crimes that had been investigated. (Int. B.21–22) Their view was that a conspiracy indictment was still possible, but it would have to be obtained before September 1983 even under the most creative theories on how to extend the statute of limitations. (Int. B.21–22 and A.14)

Aronica advanced a plan as to how such a deadline could be met. His plan would have required a major allocation of manpower at the 11th hour, i.e., several teams of attorneys operating in several grand juries with one or two attorneys at the focal point. Aronica believed further investigation would uncover additional evidence of wrongdoing based on his own and Weiner's investigation. (Int. A.14–15)

Jensen's decision was to terminate the investigation. In his letter dated August 30, 1983, informing the Navy of his decision, Jensen said: "the dominant reason influencing our judgment is the absence of sufficient evidence to prove the existence of a criminal conspiracy to submit false claims or to defraud the United States." He said in the staff interview that in the end he "arrived at the conclusion that the matter should be closed." (Ex. HH and Int. M.5)

III. DEFENSE PROCUREMENT FRAUD AND THE JUSTICE DEPARTMENT

A. THE VIEWS OF JENSEN AND OLSEN

Assistant Attorney General Jensen (now a U.S. District Court judge) and his former deputy, Assistant Attorney General Roger Olsen, indicated in the staff interviews that problems in the management of major defense fraud cases have been persistent.

In 1978, as Justice was considering what to do with Newport News and two other shipbuilding cases referred to it by the Navy, Mark M. Richard, Chief of the Fraud Section, urged the establishment of a specialized group to handle the cases. Under Richard's approach, which was influenced by experiences with earlier Navy shipbuilding cases, the group would be composed of Justice attorneys and Defense Department auditors. The Richmond investigative team was set up along those lines, the major difference being that control was divided between Justice and the U.S. Attorney's Office.

Jensen states that problems in the Newport News case contributed to the decision in 1982 to establish within Justice the Defense Procurement Fraud Unit (DPFU). Jensen said he had in mind a defense procurement "strike force" type of organization. While the Newport News case was not the proximate cause of the decision to create DPFU, he said, all the shipbuilding cases led to a rethinking of the Justice Department's approach to defense fraud. (Int. M.7)

Jensen said the Newport News investigation had been disjointed and driven by fortuitous decisions about staffing, depending upon what attorney might be available at the time. In light of those problems, it became evident there was a need to have identifiable resources available on a continuing basis to handle these kind of cases. The specific purpose of establishing a fraud unit, Jensen said, was to make available attorneys with procurement expertise for full-time assignment to complex procurement cases such as Newport News. If the DPFU had been in place when Justice accepted Newport News, unquestionably that case would have been assigned to it. (Int. M.7)

Jensen said that, while DPFU was an improvement over the previous system for handling defense procurement fraud cases, there is still a "developmental process" in this area that may be changed. Jensen said it would make sense to have fraud units located in other parts of the country, such as Los Angeles, where defense contractor business is concentrated. (Int. M.7–8)

In the staff interview, Olsen also addressed some of the larger questions. He said that it was his job to try to narrow the issues for Jensen when disputes arose between attorneys as occurred in the Newport News case. But he was prompted to form an opinion that was broader than the case. He came to the view that there was something wrong with the way the Justice Department was equipped to handle major Defense Department procurement fraud cases. He cited the difficulty in getting Justice attorneys "up to speed" in procurement cases. The subject matters are frequently technical and the cases difficult to learn. He said staffing is a problem because the cases are often of a long-term nature and turnover of attorneys interferes with the ability of Justice to manage long-term cases. (Int. G.14)

Olsen stated that, regardless of the final decision on Newport News, the case "was an unfortunate example of the way DOJ deals with these [defense procurement] problems." He said it was his suggestion to create DPFU as a way to improve Justice's ability to respond to procurement fraud cases in a timely and effective manner. He saw creation of this unit as an answer to the problem of the institutional inability to assign people to defense procurement fraud cases for long periods of time. Attorneys assigned to it would be expected to work in the defense procurement area exclusively and to become familiar with procurement concepts and technical matters. The location of the unit in Alexandria, Virginia, gave it a possible venue for many cases because the Pentagon and the Navy's procurement offices in Crystal City were located nearby. This would reduce the requirement for prosecutors to travel to other jurisdictions to handle cases. Olsen pointed out that keeping prosecutors "off the road" was an important ingredient in keeping them productive and in government service. (Int. G.14-15)

Olsen acknowledged that Justice could have done a better job on the Newport News case. But he was hopeful that the DPFU, which was intended to combine the expertise of Defense and Justice Department lawyers, would result in swift and certain justice for people engaging in procurement fraud. In response to a question about the adequacy of staff resources for these kind of cases, Olsen said that Justice had not obtained budget increases in the past several years. He also observed that, with certain crimes such as narcotics violations, there is an overlap with state law enforcement authorities, but there is no one other than the Justice Department to enforce the laws against defense procurement fraud. (Int. G.20)

B. The Defense Procurement Fraud Unit

In 1983, after lengthy investigations of possible fraud in claims filed by five major shipbuilders and after prosecution was declined in three of those cases, the Justice Department conducted an internal management review of those closed investigations concerning General Dynamics, Lockheed, and Bath. (Ex. FF) The Department's review did not examine the Newport News investigation which was still pending, nor the investigation of Litton which had led to an indictment dismissal.

The internal review found a series of institutional weaknesses which may have contributed to the lack of success in those cases. Among the problems recognized were: (1) little expertise in procurement law or voluminous document cases among assigned prosecutors; (2) frequent turnover among assigned prosecutors and investigators; (3) minimal supervision; (4) a lack of investigation plans and schedules; (5) insufficient coordination between Justice and the Defense Department, as well as between Justice's Criminal Division and U.S. Attorneys' offices; and (6) a serious underestimation of the size and complexity of the investigations.

In response to the problematic shipbuilding investigations and to complaints from the Defense Department that Justice was not providing adequate prosecutive support for Defense fraud cases, the two agencies formed the DPFU in August 1982. Defense Secretary Caspar Weinberger and Attorney General William French Smith agreed in a formal memorandum of understanding that both agencies would contribute staff resources. However, DPFU was established within the Justice Department's Criminal Division which would control management as well as all prosecutive decisions.

The stated purpose of DPFU was to "deter future fraud by conducting nationally significant procurement fraud and corruption investigations and prosecutions." (Letter from Justice to Senator Grassley, March 13, 1985) More specifically, the Unit was created to prosecute the following types of cases: (1) those that are too complex or beyond the interest and resources of U.S. Attorney's offices; and (2) those that involve multiple venues and are beyond the operational jurisdiction of any single U.S. Attorney's office. Additionally, Justice indicated that the DPFU was intended to correct the "numerous problems" experienced with investigations such as Litton and General Dynamics.

However, less than three years after DPFU's inception, representatives from both Justice and Defense publicly decried the overall state of procurement fraud law enforcement. Justice in its Economic Crime Council study of April 1985 reported that, despite some progress in detection and prosecution, the overall number of cases continue to be too few to represent an adequate level of enforcement. The Council blamed the lack of effectiveness on a "disturbingly low" number of quality referrals from the Defense Department.

Defense Department Inspector General Joseph Sherick testified before Congress with a different view about where the system is lacking. Sherick said that, while the existence of DPFU helped prosecutors focus more on procurement fraud, he was "unsatisfied" with the minimal number of cases handled by DPFU. The Inspector General went on to say that the government remains "overmatched" in its efforts against fraudulent contractors, and that taxpayers are "getting their clock cleaned." (Hearings, "Defense Procurement Fraud Law Enforcement," Subcommittee on Administrative Practice and Procedure of the Senate Committee on the Judiciary, 99th Congress, 1st Session, 1985)

Following that testimony, Senator Grassley, Chairman of the Subcommittee on Administrative Practice and Procedure, asked GAO to review the operations of the DPFU since its creation in 1982. GAO examined cases referred to the DPFU from 1982 through December 1985 and found that, of 486 defense procurement fraud cases referred for Unit action, by July 1986 DPFU had participated in 34 successful convictions (7 percent). Most of the convictions involved smaller companies. (GAO, "Defense Procurement Fraud, Cases Sent to the Department of Justice's Procurement Fraud Unit," September 1986)

In general, GAO found that DPFU produced few successful prosecutions of major contractors, accepted many cases involving minor or no dollar loss, and appeared to have lost track of some cases brought to the Unit. GAO's findings also show many cases pending with DPFU for two years or more, and a high staff turnover rate. Most attorneys and investigators stayed with the Unit for periods less than two years.

Under the agreement between Justice and Defense, all significant defense fraud cases are referred to DPFU for the Unit Chief to determine one of four actions: (1) accept the case for DPFU prosecution; (2) accept the case for prosecution but refer it to a U.S. Attorney's office; (3) send the matter back to Defense for more investigation; or (4) decline prosecution. The GAO study found that roughly one-quarter of all referrals were assigned to each of the four categories, resulting in just over half of those cases referred (261) being accepted for prosecution by either DPFU or U.S. Attorneys.

From the 261 cases DPFU accepted for prosecution between 1982 and 1986, there have been 42 total convictions with DPFU, as mentioned above, claiming involvement in 34. Because some investigations produced multiple convictions, the GAO report shows DPFU actually participated in 15 separate successful investigations. Of 156 referrals involving major contractors (top 100 in volume of sales to the Defense Department), nine resulted in convictions, with local U.S. Attorneys prosecuting six of those cases and DPFU participating in three.

Most of the major contractor cases referred (105 of 156) involved the Defense Department's "top 25" contractors. Four of the nine convictions of major contractors were among the "top 25." DPFU participated in just one case involving a "top 25" defense contractor.

That case, one of the first handled by DPFU prosecutors, resulted in the Sperry Corporation pleading guilty to mischarging $325,000 of extra costs onto government contracts. Sperry agreed to pay a fine. The plea agreement worked out between DPFU and Sperry attorneys was initially labeled "unconscionable" by the presiding Federal District Court judge due to its failure to charge individuals, but he later accepted it.

Sperry's agreement with the government, known as a "global" settlement, protected Sperry from suspension or debarment from government contracts as a result of the conviction and had the effect of halting a second criminal investigation of similar practices at another Sperry facility. That investigation was halted because the agreement immunized Sperry for any illegal cost mischarging up to the date of the settlement.

Inspector General Sherick called the Sperry agreement a "disgrace" and a "travesty" in congressional testimony. (Hearings, Senate Judiciary Subcommittee on Adminstrative Practice, October 1985) In the wake of criticism from the Defense Department, the Justice Department announced it would no longer enter into "global" agreements.

The other two convictions of major contractors in which DPFU participated involved Gould Defense Systems and GTE Government

Systems Corporation. There were plea agreements in both resulting in fines.

According to GAO, while a number of pending cases involve top 100 contractors, DPFU has not participated in a successful prosecution of a top 100 defense contractor since October 1985.

DPFU "screens" cases to determine which ones to accept for prosecution. Approximately 62 percent of DPFU's accepted cases involve estimated losses of less than $1 million. Nearly 40 percent of DPFU's cases fall into the category of no loss or "unknown" loss.

Many of the unknown loss cases may be among the numerous referrals to DPFU for which it could not render an accounting. According to GAO, DPFU lacked any records which could show the reason for the referrals or what action, if any, had been taken on 58 cases.

In light of the staff turnover problems cited in the shipbuilding fraud investigations, GAO was also asked to examine the staffing of the DPFU. At its inception, eight full-time attorneys were assigned to DPFU: three from the Criminal Division, one from the Civil Division, one Assistant U.S. Attorney, and three from the Defense Department. GAO found that two of the original three Criminal Division prosecutors assigned to the DPFU, including the Unit Chief, left within two years to enter private practice. The third left DPFU after two and a half years. Both the Civil Division attorney and the Assistant U.S. Attorney were still assigned to DPFU as of March 1986. Two of the original three Defense Department attorneys were reassigned after two and a half years. As of July 1986, the staff's average tenure with the Unit totaled about 18 months.

The DPFU has increased its staff since 1982. In July 1986, the staff included seven criminal prosecutors, two civil attorneys, one of whom was on temporary assignment elsewhere, five investigators, and five Defense Department attorneys. In the October 1985 hearing before the Senate Judiciary Subcommittee on Adminsitrative Practice and Procedure, Justice representatives testified that the resources devoted to DPFU were adequate and that extra resources, if needed, could always be borrowed from the Criminal Division. The Justice Department's Fiscal Year 1988 budget request includes an allowance for three additional attorneys to be assigned to DPFU.

IV. SUMMARY AND CONCLUSIONS

The history of the Newport News Shipbuilding investigation reveals inefficiencies, unexplained lapses, and systemic problems in the Justice Department's management of major defense fraud cases. Establishment of the Defense Procurement Fraud Unit within the Justice Department was intended to correct the type of deficiencies experienced in the Newport News case. While some progress is evident in the overall detection and prosecution of procurement fraud, systemic weaknesses continue to plague the Justice Department's efforts, especially with regard to complex cases involving major contractors.

The Justice Department's approach to the Newport News investigation was to assign responsibility for the investigation to the U.S. Attorney in Alexandria, Virginia, while retaining authority to make the final decision on whether to prosecute. Navy attorneys were assigned to the investigative team, but were given no role in decisions about investigative strategy and a minor role in determining recommendations to the U.S. Attorney. This system of dividing responsibility and authority was ultimately fatally flawed. It contributed to staffing problems, caused delays, and defeated the underlying purpose of a mixed investigative team. Instead of a combined force providing increased effectiveness, there was a divided force that proved ineffective.

The approach of DPFU has resulted in some of the same problems, including inadequate numbers of staff and excessive staff turnover. Defense Department attorneys and Justice Department civil attorneys assigned to DPFU play a minor role, primarily in the screening of referrals from Defense. The objective of establishing an effective investigative and prosecutive unit of identifiable resources available on a continuing basis to handle major defense fraud cases has still not been achieved.

Serious mistakes were made at every stage of the Newport News investigation and much time wasted during lengthy periods of inactivity. There was poor supervision of prosecutors and investigators, questionable decisions at the prosecutorial and managerial levels, excessive staff turnover, and inadequate coordination within the Justice Department and between Justice and the Navy. There is strong evidence that the statute of limitations on the substantive offenses of false claims and false statements was allowed to lapse before the case was closed.

These problems occurred even though it had been recognized at the highest levels within the Justice Department when the investigation began that prior experiences with Navy shipbuilding fraud cases were unsatisfactory and that a better approach was needed.

The following is a more detailed list of conclusions.

A. THE NEWPORT NEWS INVESTIGATION

1. The Justice Department allowed two years to lapse without conducting any investigation from the time allegations and evidence of possible fraud were first referred to it in 1976 by Senator William Proxmire. The Proxmire referral was based on information provided in congressional hearings by Admiral H.G. Rickover and William R. Cardwell, a former long-time employee of Newport News. Cardwell eventually testified before the grand jury, but years later was considered no longer to be a reliable witness because of the passage of time.

2. After agreeing to share responsibility for the Newport News matter with the U.S. Attorney's Office in Alexandria, Virginia, the Justice Department failed to carry out its responsibility for advancing the investigation. The attorneys assigned to the investigation by Justice worked on it only part time, were replaced after short intervals without notifying the U.S. Attorney's Office, and made little contribution to the case.

3. The Assistant U.S. Attorney placed in charge of the Richmond phase of the investigation did not have substantial prior experience in major criminal cases. The Richmond investigative team received insufficient supervision from the U.S. Attorney's Office and was inadequately staffed.

4. The head of the Richmond team failed to give adequate consideration to the findings and views of the Navy attorneys assigned to the team, or to take full advantage of the Navy's offer to provide technical assistance. The Richmond prosecutor apparently did not understand the significance of some of the evidence obtained, and did not pursue all avenues of possible prosecution.

5. The head of the Richmond team did not properly carry out the directions of the U.S. Attorney to conduct further investigation following the submission of his initial recommendations in March 1980. A key witness, who was a high official of Newport News, was mistakenly given full immunity and questioned outside the presence of the grand jury, contrary to the instructions of the U.S. Attorney. The purpose for which further investigation was directed—comprehensive scrutiny of a particular part of the claim, the Ventilation Control Air System (VCAS) item—was not achieved.

6. The U.S. Attorney's Office in Alexandria, Virginia, renewed the grand jury investigation in early 1981 and uncovered new evidence about the VCAS item. In the view of the Alexandria prosecutors, the new evidence established the methodology of how the false aspects of the claim were prepared. The prosecutors forwarded a report to the Justice Department in November 1981 concluding that there was evidence of fraud and a criminal conspiracy, and requesting staff assistance to complete the investigation. The report urged that the investigation be completed by the middle of 1982 to avoid statute of limitations problems. But from the date of the report until the case was closed in August 1983, there were no further grand jury proceedings or other efforts to advance the investigation.

7. In November 1981, Elsie Munsell, the new U.S. Attorney in Alexandria, abolished the Fraud Division in her office which had responsibility for the Newport News case, and reassigned the two

prosecutors who had worked on it. This action was taken without consulting the previous U.S. Attorney or officials in the Justice Department, and over the objections of Joseph Fisher, the Alexandria prosecutor who had been in charge of the investigation. The reorganization sidetracked the investigation and reduced prospects for completing it in the U.S. Attorney's office.

8. In January 1982, U.S. Attorney Munsell asked the Justice Department to reassume responsibility for the Newport News case. Justice advised her in March that it would take back the case. The shift in responsibility for the investigation led to further discontinuity and delays.

9. The Justice Department decided to review the case to determine whether the investigation should be continued or ended. There was an additional delay and confusion in beginning the review as Justice officials searched for an attorney to work on the case. Ed Weiner, the Justice attorney selected to conduct the review, did so without supervision. Officials at the Criminal Division level assumed the Fraud Section was supervising it. The Chief of the Fraud Section assumed it was being supervised at the Criminal Division level.

10. Ed Weiner submitted a report on August 5, 1982, agreeing with the Alexandria prosecutors that there was evidence of fraud and a criminal conspiracy, and recommending that the investigation be continued. Later, Mr. Weiner was directed to search the files again for additional evidence of fraud. Mr. Weiner did, in fact, uncover what he viewed as new evidence of fraud. Nevertheless, Mr. Weiner's superiors in the Fraud Section decided in November 1982 to recommend to their superiors at the Criminal Division level that the case be closed. There was additional delay as the Fraud Section report recommending that the case be closed was not sent to Lowell Jensen, Assistant Attorney General for the Criminal Division, until February 25, 1983.

11. Robert Ogren, Chief of the Fraud Section, strongly argued in his report to Assistant Attorney General Jensen that by February 1983 the statute of limitation had expired on the substantive crimes of false claims and false statements. Mr. Jensen's letter informing the Navy that the dominant reason for closing the case was the absence of sufficient evidence to prove a criminal conspiracy is consistent with the view that the statute of limitations would have barred prosecution of the substantive offenses.

12. The statute of limitations would not have been a bar to prosecution on charges of conspiracy. The Alexandria prosecutors believed there was substantial evidence of fraud and conspiracy, that more evidence could be found, and that the investigation should have been continued. The Justice Department attorney who reviewed the case agreed with the Alexandria prosecutors. The Justice Department supervisors concluded that, although there was evidence of fraud, there was insufficient evidence on which to base a prosecution.

13. There was additional delay as the final decision by Assistant Attorney General Jensen to close the case was not made until August 1983.

B. THE DEFENSE PROCUREMENT FRAUD UNIT

1. The Justice Department's Defense Procurement Fraud Unit has not sufficiently corrected the numerous problems encountered with previous investigations of major shipbuilders.

2. DPFU has experienced excessive staff turnover, and effective coordination with the Defense Department still appears to be in need of improvement.

3. DPFU has produced few successful prosecutors of major contractors. As of July 1986, the Unit had participated in only three convictions of major defense contractors. In all three cases, the sentences were limited to fines.

4. DPFU appears to lack an adequate recording system for cases referred to it. According to the General Accounting Office, the Unit could not produce records showing the reasons for actions, if any, taken with regard to 58 case referrals.

APPENDIX

EXHIBIT A

MAY 19, 1977 -- LETTER FROM NAVSEA 08 (RICKOVER) TO INSPECTOR GENERAL, NAVSEA

DEPARTMENT OF THE NAVY
NAVAL SEA SYSTEMS COMMAND
WASHINGTON, D.C. 20362

IN REPLY REFER TO
May 19, 1977

From: Deputy Commander, Nuclear Propulsion Directorate (NAVSEA 08)
To : Navy Claims Settlement Board (NAVMAT 00X)
Inspector General, Naval Sea Systems Command (NAVSEA 00N)

Subj: Newport News Claim Under CVN 68/69 Construction Contract N00024-67-C-0325; Preliminary Claim Item Technical Analysis Report (CITAR), 3.2.11, "Intermediate Gage Cutout Valves"

Ref : (a) NAVSEAINST 5371.1 of 11 Dec 74

Encl: (1) Preliminary CITAR 3.2.11 (6 copies - Navy Claims Settlement Board; 2 copies - Inspector General, Naval Sea Systems Command)

1. NAVSEA 08 analysis to date of the Newport News' claims indicates that many items are greatly inflated and appear to be an attempt to make the Government pay for work which is Newport News' contractual responsibility. An example is Claim Item 3.2.11, "Intermediate Gage Cutout Valves" submitted by the company under the contract for construction of the CVN 68 and CVN 69. Six copies of the subject Claim Item Technical Analysis Report (CITAR 3.2.11), prepared by NAVSEA 08, are hereby furnished to the Navy Claims Settlement Board.

2. In this claim item, Newport News alleges that the Government's reactor plant design agent for CVN 68 Class aircraft carriers revised systems diagrams in 1974 to require the addition of 124 intermediate gage cutout valves in seven CVN 68/69 non-reactor plant propulsion systems; that nothing in the specifications of Contract N00024-67-C-0325 can be interpreted as a requirement for these valves; and that excessive effort was expended by Newport News in complying with the revised diagrams. Newport News requests an increase of $222,230 in the target cost of the contract for this claimed effort.

3. NAVSEA 08 evaluation of this claim item indicates that the diagram revisions cited by Newport News assigned identification numbers to intermediate gage cutout valves, most of which were required by initial issue of the diagrams developed by the shipbuilder in the period 1968 - 1970; that the design

effort associated with these seven propulsion plant systems was Newport News' responsibility under the terms of the construction contract; that the design agent did not revise the diagrams, as claimed, and in fact had no contractual responsibility for the systems in question; that the construction contract specifications expressly require valves which perform the function that intermediate gage cutout valves provide; and that Newport News repeatedly assured the Government that implementation of these diagrams did not require a contract change.

4. Reference (a) defines fraud as any willful means of taking or attempting to take unfair advantage of the Government including but not limited to deceit either by suppression of the truth or misrepresentation of a material fact. Reference (a) requires any person in the Naval establishment who has knowledge of possible fraud to report such knowledge to appropriate authorities. Accordingly, two copies of the subject Claim Item Technical Analysis Report are herewith provided to the Inspector General, Naval Sea Systems Command (NAVSEA 00N).

H. G. RICKOVER

EXHIBIT B

JULY 14, 1977 -- LETTER FROM NAVSEA 08 (RICKOVER) TO INSPECTOR GENERAL, NAVSEA

DEPARTMENT OF THE NAVY
NAVAL SEA SYSTEMS COMMAND
[redacted] WASHINGTON, D.C. 20362

JUL 14 1977

IN REPLY REFER TO

From: Deputy Commander, Nuclear Propulsion Directorate (NAVSEA 08)
To: Navy Claims Settlement Board (NAVMAT OOX)
Inspector General, Naval Sea Systems Command (NAVSEA OON)

Subj: Newport News Claim Under CGN 38-41 Construction Contract N00024-70-C-0252, Preliminary Claim Item Technical Analysis Report (CITAR), 5.2.8, Reactor Compartment Ventilation Control Air System

Ref: (a) My letter of 19 May 1977 to NAVMAT OOX and NAVSEA OON
(b) Hearings before the House Appropriations Committee Subcommittee on the Department of Defense Concerning Department of Defense Appropriations for 1978, Part 4
(c) NAVSEAINST 5371.1 of 11 Dec 74

Encl: (1) Preliminary CITAR 5.2.8 (6 copies - Navy Claims Settlement Board; 2 copies - Inspector General, Naval Sea Systems Command)
(2) Two copies ref (b) - Inspector General, Naval Sea Systems Command

1. In reference (a) I reported that NAVSEA 08 analysis to date of the Newport News claims indicates that many items are greatly inflated and appear to be an attempt to make the Government pay for work which is Newport News' contractual responsibility. Reference (a) enclosed an example, Claim Item 3.2.11, Intermediate Gage Cutout Valves, submitted by the company under the contract for construction of the CVN's 68-70.

2. The Defense Subcommittee of the House Appropriations Committee held hearings concerning shipbuilding claims on 22-24 March 1977. The record of those hearings and supplemental material furnished for the record, reference (b), was released by the Committee on 20 June 1977. My comments concerning shipbuilding claims are contained on pages 381 to 718 of that record. My summary of the Newport News claims situation appears on pages 483 to 499. Some specific examples of how Newport News has inflated or exaggerated their claims are cited on pages 496 to 498, 503, and 570 to 574.

3. Another example of a Newport News claim which appears to be an attempt by Newport News to shift to the Government the responsibility to pay for work which is the shipbuilder's contractual responsibility is Claim Item 5.2.8, the Reactor Compartment Ventilation Control Air System, submitted by the company under the contract for construction of the CGN's 38-41. The reactor compartment ventilation control air system is one of the individual systems that comprise the reactor plant. In this claim item, Newport News alleges that the contract specifications for this system were so vague and misleading that the Contractor did not recognize the extensive differences between the CGN 36 and the CGN 38 for this system until years after the contract for the CGN 38 Class was definitized. The Contractor alleges that the Government is therefore responsible to increase the

[redacted]

[redacted]

target cost by the difference between his present estimate of the cost of this system in the CGN 38 Class ships and his estimate of the cost of the simpler system in the CGN 36. The Contractor requests an adjustment in target cost of $918,216 plus profit, target to ceiling spread, and escalation for CGN's 38, 39, and 40.

4. NAVSEA 08 evaluation of this claim item indicates that the Contractor's allegations of deficient Government specifications are a misrepresentation of the facts. The specifications for this system in the CGN 38 Class were specifically changed from those for CGN 36 to spell out the requirements for the more complex control air system in the CGN 38 Class. The specifications for CGN 38, unlike those for CGN 36, included a separate diagram entitled "Diagram Reactor Compartment Ventilation Control Air System" that showed the interconnection between and listed the individual components such as the valves, manifolds, air flasks, pressure gages, and other components comprising the system. The Contractor's claim includes pricing for buying and installing itemized components that were shown and tabulated on the original contract guidance drawing that is part of the Ship's Specifications.

5. As noted in reference (a), reference (c) defines fraud as any willful means of taking or attempting to take unfair advantage of the Government including, but not limited to, deceit either by suppression of the truth or misrepresentation of a material fact. Reference (c) requires any person in the Naval establishment who has knowledge of possible fraud to report such knowledge to appropriate authorities. Accordingly, two copies of the subject Claim Item Technical Analysis Report and two copies of reference (b) are provided herewith to the Inspector General, Naval Sea Systems Command (NAVSEA 00N).

6. I note that by letter to the Secretary of the Navy dated 11 June 1976 the Chairman of the Subcommittee on Priorities and Economy in Government of the Congressional Joint Economic Committee requested "a formal investigation to determine whether there is substantial evidence that the shipbuilding claims filed by Newport News Shipbuilding may be based on fraudulent representations." The Chairman also noted that "on two prior occasions I have requested the Navy to investigate the possibility of false claims. In both cases, involving Lockheed and Litton, the claims were referred to the Justice Department for criminal investigation following inquiries by the Navy." In his response of 24 June 1976, the Secretary of the Navy stated:

> "The Navy is now evaluating the recently submitted Newport News claims. Employment of a detailed multi-disciplined team approach in evaluating these claims, it is believed, will uncover evidence of any fraud.... I can assure you that if there should be indication of fraud, the matter will be referred to the Department of Justice."

[redacted]

[redacted]

7. I do not know what action, if any, has been taken over the past 13 months to fulfill the Secretary of the Navy's commitment cited above. However, in order to fulfill the responsibilities of the Naval Sea Systems Command, the organization responsible for the Newport News shipbuilding contracts, I recommend that the Inspector General, Naval Sea Systems Command, formally ask the Navy Claims Settlement Board and the Supervisor of Shipbuilding, Newport News to report any indication of possible fraud they may have uncovered in their extensive reviews to date of the Newport News claims. As a minimum, I would expect that each claim item for which it has been concluded that there is no Contractor entitlement should be considered as possibly representing a false claim.

8. The NAVSEA 08 claims analysis group is currently analyzing additional Newport News claim items totaling millions of dollars in requested adjustments in target costs to Newport News contracts which also appear to be examples of Newport News' attempts to shift to the Government the responsibility to pay for work which is the shipbuilder's contractual responsibility. These Claim Item Technical Analysis Reports will be forwarded when they are complete.

H. G. Rickover

[redacted]

EXHIBIT C

NOVEMBER 1, 1977 -- LETTER FROM NAVSEA 08 (RICKOVER) TO INSPECTOR GENERAL, NAVSEA

DEPARTMENT OF THE NAVY
NAVAL SEA SYSTEMS COMMAND
WASHINGTON, D.C. 20362

IN REPLY REFER TO

1 November 1977

[redacted]

From: Deputy Commander, Nuclear Propulsion Directorate (NAVSEA 08)
To: Navy Claims Settlement Board (NAVMAT 00X)

Inspector General, Naval Sea Systems Command (NAVSEA 00N)

Subj: Newport News Claim Under CVN 68/69 Construction Contract N00024-67-C-0325; Preliminary Claim Item Technical Analysis Report (CITAR) 3.2.2, "Mock-Up Design Problems (MUDP's)"

Ref: (a) My ltr of 19 May 1977 to NAVMAT 00X and NAVSEA 00N
(b) My ltr of 14 Jul 1977 to NAVMAT 00X and NAVSEA 00N
(c) NAVSEAINST 5371.1 of 11 Dec 1974

Encl: (1) Preliminary CITAR 3.2.2 (6 copies - Navy Claims Settlement Board; 2 copies - Inspector General, Naval Sea Systems Command)

1. In my testimony before the Defense Subcommittee of the House Appropriations Committee on 24 March 1977, I reported that shipbuilding claims have taken on a common pattern, characterized by "imaginative" legal theories; failure to document cause and effect; and the use of inflated, unsubstantiated cost estimates. Frequently the bottom line alleged in the claims is that the Government is responsible for all losses projected or incurred on the contracts. The claims rarely, if ever, acknowledge Contractor errors.

2. A case in point is the Newport News claims. If these claims were paid at face value, the company would recover all costs plus a substantial profit—despite major labor turbulence, low productivity, and other contractor-responsible problems encountered during performance of the contracts. It is not surprising, therefore, that scrutiny of these claims indicates there are many items which appear to be an attempt by the company to make the Government pay for work which is Newport News' contractual responsibility. With reference (b), I enclosed the record of the Defense Subcommittee's hearing which cited specific examples of such claim items.

3. The use of omnibus, inflated, and unsubstantiated claims to reprice contracts appears to be acceptable to some, on the basis

[redacted]

that it should be taken for granted that the contractor will overstate his case; that claims are merely the starting point for negotiations; and that the Government will have an opportunity to separate the "grain from the chaff" in the claims analysis. Claims containing allegations which are untrue or misleading are justified by some on grounds that these misrepresentations are mere "puffing"—whatever that may be. Further, inflated claims provide the opportunity, endorsed by some, to pay large amounts beyond what is contractually owed on the basis of "litigative risk",while still settling the claim at far less than the amount claimed.

4. I do not see how the examples taken from Newport News' claims which I described in my testimony before the Defense Subcommittee, and the additional two items I brought to your attention by references (a) and (b), can be rationalized as "puffing." In accordance with reference (c), I brought these matters to the attention of the NAVSEA inspector General for investigation of possible fraud.

5. Mr. John Diesel, Chief Executive Officer and Chairman of the Board of Newport News Shipbuilding and Dry Dock Company, has stated publicly, including testimony to Congress, that Newport News' claims contain only items for which the Government is responsible; that the $894 million increase in ceiling prices claimed is a legitimate representation of work added by the Government and does not include costs for which the contractor is responsible. For example, in a November 18, 1976, speech before a civic organization in Newport News, Mr. Diesel stated:

> "Some of the instant experts have characterized these claims as 'cost overruns.' This is not the case. Sometimes we make mistakes, and our costs sometimes do exceed our estimates. But our claims against the Navy do not reflect our own errors. They include only the cost impact of Government actions, including changes in ship design and construction ordered by the Navy and late and defective Government-furnished equipment and information."

Also, Mr. Diesel informed the Defense Subcommittee that:

> "We did not start with a fixed amount of money. We took each element that we felt was truly Government responsible, and costed that out, and let it fall where it may."

However, Mr. Diesel's public assurances appear to be at variance with the facts. The purpose of this memorandum is to bring to your attention another example of this disparity; i.e, Claim Item 3.2.2, "Mock-Up Design Problems" submitted by

[redacted]

Newport News under the contract for construction of the CVN's 68-70. This claim item is described in the following paragraphs.

6. Under the CVN 68 Class ship construction contract, Newport News is required to design and construct a full-scale mock-up of the port side of Main Machinery Room (MMR) No. 2. Under a separate contract, Newport News in its capacity as the Reactor Plant Planning Yard (RPPY) is required to build and maintain a full-scale mock-up of one CVN 68 Class Reactor Room. To aid in the identification and resolution of design problems in these two mock-ups, Newport News developed an internal shipyard procedure and form for reporting Mock-Up Design Problems (MUDP's). This procedure and form apply both to the shipbuilding contract for the Main Machinery Room mock-up, and to the Reactor Plant Planning Yard contract for the Reactor Room mock-up. Accordingly, the procedure title contains the reference symbols for both contracts.

7. In Claim Item 3.2.2, Newport News alleges that 214 of 9,000 MUDP's issued by the contractor's personnel involved "preference refinements, appearance improvements and access improvements" in the Main Machinery Rooms; that these MUDP's represent changed and added work; and that until the claim was prepared, the contractor was not aware that he had processed the MUDP's "without including them in the definitization baseline or without otherwise requesting compensation." The claim lists the reports of 32 inspections by NAVSEA 08 personnel to review and approve MMR No. 2 mock-up design prior to shipboard installation. The contractor implies that the 214 MUDP's claimed were a direct result of Government actions taken during these inspections. The contractor requests an adjustment in the contract target cost of $217,474, plus profit, target to ceiling spread, and escalation. Subsequently, the contractor reported that this figure should be reduced by about $4,000 because he originally overstated the number of Government-responsible MUDP's.

8. As a first step in analysis of this claim, NAVSEA 08 reviewed contemporaneous reports issued for some of the cited inspections to determine if all 214 MUDP's claimed were, in fact, NAVSEA directed rather than contractor initiated. This was thought important because only 17 MUDP's of the 214 claimed indicated on the MUDP form that the MUDP resulted from NAVSEA comments. A review of selected reports provided no basis to support the allegation that the 214 claimed MUDP's arose from Government actions.

9. Accordingly, the contractor was requested by letter of 20 September 1977 to substantiate that claimed MUDP's were issued at the direction of NAVSEA representatives during their inspections of the Main Machinery Room mock-up. The purpose

[redacted]

of this request was to verify the contractor's apparent criteria for selecting the specific MUDP's claimed out of the total population of 9,000 MUDP's allegedly issued.

10. The contractor's reply of 29 September 1977 failed to provide the requested substantiation; was ambiguously worded; and merely reasserted the general allegation that the Government's "continuing extensive reviews of the mock-up caused innumerable design changes." The reply stated that no attempt had been made to tie claimed MUDP's to specific inspections since such a review "was not practical." The contractor's response implied that all 9,000 MUDP's arose from Government direction and that the 214 claimed represented those which involved work beyond contract requirements. The fact is that many MUDP's were issued by the contractor entirely at his own initiative. Also, the contractor's response alleges Government responsibility on grounds that the Government's Reactor Plant Planning Yard (RPPY) wrote the procedure for reporting MUDP's. Neither the claim nor the contractor's response notes that the scope of the MUDP procedure applies to both the shipbuilding contract and the Reactor Plant Planning Yard (RPPY) contract, as the reference symbols in the procedure title clearly indicate. Nowhere in the claim or in its supporting data did the contractor explain that Newport News' personnel reviewing the MMR No. 2 mock-up were acting in their shipbuilding, not RPPY, capacity.

11. NAVSEA 08 review of CVN 68 Claim Item 3.2.2, and the contractor's subsequent reply, indicates that allegations of Government-directed work beyond the scope of the contract constitute a misrepresentation of fact, as follows:

- Despite the clear implications in the claim and subsequent correspondence from the contractor that the 214 claimed MUDP's were generated as a result of NAVSEA inspections of the CVN 68 MMR No. 2 mock-up, 36 of the claimed MUDP's were issued prior to the first NAVSEA MMR No. 2 mock-up inspection cited in the claim.

- Only 17 of the claimed MUDP's contain notations indicating a NAVSEA comment was involved in issuance of the MUDP. For the remaining 197 MUDP's, the contractor has provided no information to corroborate the assertion that these MUDP's were issued at the Government's direction. The contractor apparently has made no attempt to segregate MUDP's he initiated from those originating from comments by NAVSEA personnel. Instead, the contractor appears to have "backed out" all MUDP's he now considers to be changes, and asserted these in the claim regardless of how they were actually initiated.

[redacted]

- Contrary to the allegation in the claim that 214 specific MUDP's constituted changes under the contract, analysis of each of these MUDP's shows that none required work beyond the scope of the shipbuilding contract to comply with specific sections of the Ship's Specifications, as shown in the attached Claim Item Technical Analysis Report.

- To the extent that some of the MUDP's may have been issued as a result of NAVSEA inspection of the Main Machinery Room mock-up, the Ship's Specifications expressly provide that the contractor is responsible to make any changes resulting from NAVSEA mock-up inspections.

- Contrary to the implication in the claim that Newport News could not have contemplated that the mock-up would be inspected to the standards used by NAVSEA, it should be noted that the first NAVSEA mock-up inspection cited in the claim was performed in June 1969 and 15 of the 32 inspections cited were completed before Newport News signed the definitized contract on 30 June 1970.

- No evidence has been presented that the NAVSEA inspectors abused their authority. In fact, the results of each NAVSEA mock-up inspection were fully documented and reports of inspections after 4 November 1969 included statements that the actions cited were within the scope of the contract.

- Copies of these inspection reports were furnished by the Government to the contractor shortly after the inspections, with a written admonition not to proceed with work arising from the inspections which was considered by the contractor to be beyond existing contract requirements. This admonition also provided that performance of added work, absent the contractor's obtaining contractual authorization, would be at his own expense.

- Where the contractor considers that a contract change is required, contractual procedures are available to the contractor to so notify the Government. No such notification was provided other than the claim submittal itself, several years after the claimed work was performed.

- It is not true that all 9,000 MUDP's were issued at the Government's direction. Also, the contractor's reference to the RPPY is misleading, since Newport News in its capacity as RPPY has no contractual or technical authority with respect to the MMR No. 2 mock-up except for a small amount of reactor plant piping.

[redacted]

- The contractor failed to point out that he directly benefited from the design resolutions initiated by many MUDP's which resulted in reduced construction costs.

12. Claim Item 3.2.2 appears to be a sophisticated form of misrepresentation. It advances a faulty conclusion—that the Government owes Newport News money—by relying heavily on implication and innuendo; substituting sophistry for fact and logic; and avoiding outright falsehoods while promoting misleading impressions of Government responsibility. Newport News was given the opportunity to explain, substantiate, or even retract its allegations. The questions asked by the Government were straightforward; the response given was not. Instead, the Company replied in the same vein as the original claim.

13. Reference (c) defines fraud as any willful means of taking or attempting to take unfair advantage of the Government including, but not limited to, deceit either by suppression of the truth or misrepresentation of a material fact. Reference (c) requires any person in the Naval establishment who has knowledge of possible fraud to report such knowledge to appropriate authorities. Accordingly, two copies of the subject Claim Item Technical Analysis Report are provided herewith to the Inspector General, Naval Sea Systems Command (NAVSEA 00N).

H. G. Rickover

EXHIBIT D

DECEMBER 30, 1977 -- LETTER FROM NAVSEA 08 (RICKOVER) TO SECRETARY OF THE NAVY

[redacted]

DEPARTMENT OF DEFENSE UNITED STATES OF AMERICA

DEPARTMENT OF THE NAVY
NAVAL SEA SYSTEMS COMMAND
WASHINGTON, D.C. 20362

IN REPLY REFER TO
30 December 1977

From: Deputy Commander, Nuclear Propulsion Directorate (NAVSEA 08)

To: Secretary of the Navy

Subj: Newport News Claim Under CVN 68 Class Construction Contract N00024-67-C-0325; Claim Items 4.1.1, "Government Responsible Delay - USS NIMITZ (CVAN 68)" and 4.1.2, "Government Responsible Delay - USS DWIGHT D. EISENHOWER (CVAN 69)"

Ref:
(a) My letter of 19 May 1977 to NAVMAT 00X and NAVSEA 00N
(b) My letter of 14 Jul 1977 to NAVMAT 00X and NAVSEA 00N
(c) My letter of 1 Nov 1977 to NAVMAT 00X and NAVSEA 00N
(d) My letter of 18 Nov 1977 to NAVMAT 00X and NAVSEA 00N
(e) My letter of 10 Dec 1977 to NAVSEA 00N and ASN(MRA&L)
(f) NAVSEAINST 5371.1 of 11 Dec 1974

Encl: (1) NAVSEA 08 Comments on Selected Specific Newport News' Allegations Contained in CVN 68 Class Claim Item 4.1.1, "Government Responsible Delay - USS NIMITZ (CVAN 68)"

1. The purpose of this memorandum is to report that Claim Item 4.1.1, "Government Responsible Delay - USS NIMITZ (CVAN 68)" and Claim Item 4.1.2, "Government Responsible Delay - DWIGHT D. EISENHOWER (CVAN 69)" submitted by Newport News under the contract to construct CVN's 68-70 may warrant investigation for possible violation of fraud or false claims statutes.

2. By references (a) through (e), in accordance with reference (f), I brought to the attention of the Inspector General, Naval Sea Systems Command, numerous items from the claims submitted by Newport News and Electric Boat which appear to be attempts by these companies to make the Government pay money it does not owe. These reports describe items in the Newport News and Electric Boat claims which are examples of:

- Statements which are demonstrably untrue.
- Statements apparently designed to mislead.
- Withholding of documents which would disprove allegations of Government responsibility.
- Alleged Government responsibility for costs which are the shipbuilder's responsibility under the contract.
- Claims for costs that have already been reimbursed.
- Claims for costs which have not or will not be incurred.

[redacted]

[redacted]

These reports were forwarded by the NAVSEA Inspector General via the Commander, Naval Sea Systems Command and the Chief of Naval Material to the Navy General Counsel for appropriate action. I understand that the reports have taken as long as six weeks to reach the General Counsel. I further understand that two attorneys in the Office of the Navy General Counsel have been assigned, on a part-time basis, to review and evaluate these reports, as well as reports by others, to determine whether the Navy should send the claims to the Justice Department for investigation of possible violation of fraud or false claims statutes.

3. I have assumed that, because of your interest in the shipbuilding claims issue and the gravity of possible violations of fraud or false claims statutes, you would be kept informed of reports of possible false or fraudulent shipbuilding claims and that you would be consulted on how this issue is being handled. However, based on my understanding of the testimony to the Congressional Joint Economic Committee yesterday by the Assistant Secretary of the Navy (Manpower, Reserve Affairs, and Logistics) and the Navy General Counsel, this may not be the case. Therefore, I am addressing this memorandum to you to ensure that the attention, priority, and resources applied to this matter are in accordance with your directions.

4. In Claim Item 4.1.1, the Contractor attributes 160 days of delay in delivery of CVN 68 to numerous allegedly Government responsible problems encountered in the CVN 68 lead reactor plant acceptance test program, stated by the Contractor to be "the sequence which controlled vessel delivery." The thrust of this claim item is that the Government alone is responsible for the entire 123-day interval between actual delivery of CVN 68 on 11 April 1975 and the contract delivery date of December 9, 1974. The difference of 37 days, between 160 days of allegedly Government responsible delay and 123 days of actual delay, is attributed by Newport News to the mitigating effect of Contractor actions. In Claim Item 4.1.1, the Contractor states:

[redacted]

[redacted]

> "Through the efforts of experienced Contractor construction and testing supervisory personnel and by the optimum utilization of available labor and material resources, the Contractor was able to improve on the time that should have been required to complete and deliver the ship. A calculated 160-day delay in vessel delivery was reduced to an actual 123-day delay as a result of the intense and continuous efforts of the Contractor. Therefore, based on the documented evidence discussed in this analysis, the Contractor hereby requests a 123-day adjustment to the Contract delivery date of the USS NIMITZ as a direct result of Government responsible causes. More specifically from December 9, 1974 to April 11, 1975."

5. In Claim Item 4.1.2, the Contractor attributes 731 days of corollary delay in delivery of CVN 69 due to the alleged impact the delay of CVN 68 had on the Contractor's resources. Thus, the Contractor asserts the Government is also solely responsible for the entire 731 day interval between the delivery of CVN 69 of June 30, 1977 anticipated at the time of claim submission and the original contract delivery date of June 30, 1975. The Contractor states:

> "...because of actions of the Government as set forth and described in this proposal, the Contractor's planning and scheduling efforts were upset on a continuing basis. Late delivery of Government furnished equipment; defective receipt of Government furnished equipment; late, deficient, incomplete and inadequate Government furnished information; deficient, incomplete and ambiguous contract design caused the construction schedule and workload for CVN 69 to expand. Although many of these problems first directly affected CVAN 68, the lead ship in the class, their impact was felt on CVAN 69. Thus, Government responsible problems on CVAN 68 which resulted in increased work and delay severely hampered the CVAN 69 construction program, and it too was delayed... CVAN 68 delay caused delay to CVAN 69."

6. The "documented evidence" furnished in support of the 160 days of delay claimed in delivery of CVN 68 is a compendium of over 100 fairly specific, allegedly Government responsible problems encountered in the reactor plant test program. Each problem is assigned an amount of resultant delay (in hours or days) and categorized by the phase of the test program in which the problem allegedly occurred.

[redacted]

[redacted]

7. For the 123 days of CVN 68 delay experienced, Newport News requests an adjustment in target cost of $15,474,511, plus profit and target to ceiling spread as stated elsewhere in the claim. This amounts to a requested adjustment to contract target cost of $125,809 for each day of delay claimed.

8. For the 731 days of CVN 69 delay claimed, Newport News requests an adjustment in target cost of $52,399,181 plus profit and target to ceiling spread as stated elsewhere in the claim. This amounts to a requested adjustment to contract target cost of $71,682 for each day of CVN 69 delay claimed. Thus, for each day of delay to the CVN 68, the Contractor requests a total target cost adjustment for both ships of approximately $197,491, exclusive of claimed disruption and financing costs. Applying the ceiling to target spread to this amount indicates the Contractor is requesting, for each day of delay to the CVN 68, a total ceiling price adjustment for both ships of approximately $262,633, exclusive of claimed disruption and financing costs.

9. To assist those responsible for preparing the Navy's evaluation of this claim item, NAVSEA 08 representatives reviewed each of the CVN 68 lead reactor plant test problems cited by the Contractor as Government-responsible and alleged to have caused delay in the CVN 68. Enclosure (1) contains the NAVSEA 08 findings relative to seventeen alleged problems cited by the Contractor. Enclosure (1) is not intended to be a comprehensive analysis of Claim Item 4.1.1. There are many other portions of this claim item not addressed in enclosure (1) for which the Government has no liability under the terms of the CVN 68 Class construction contract. Enclosure (1) addresses only certain specific allegations contained in Claim Item 4.1.1, which appear to involve misrepresentation of fact or omission of material information readily available to the Company which would defeat its case that the Government is responsible for the delay claimed. The total increase in target cost of CVN 68 and CVN 69 claimed for the items discussed in enclosure (1), using the Contractor's claimed costs per day of delay, is approximately $7.3 million. The corresponding increase in ceiling price claimed for these items is approximately $9.8 million.

10. A few examples discussed in enclosure (1) include:

- The Contractor alleges that 30 hours in delay of testing occurred as a result of "the loss of [redacted] flow to the Government furnished steam generators." The estimated increase in target cost claimed is approximately $246,850 for both ships. This allegation

[redacted]

[redacted]

appears to be carefully worded to leave the impression that defective Government furnished equipment (GFE) is involved. In fact, no defective GFE was involved. Loss of [redacted] flow resulted from automatic shutdown of shipbuilder furnished [redacted] pumps occasioned by a loss of pressure in the shipbuilder responsible auxiliary exhaust system.

- The Contractor claims 20 hours delay on grounds that "Section 5.12 of Test Procedure 3-KA-23 was delayed as a result of the loss of coolant flow (unsatisfactory performance of GFE)". The estimated increase in target cost claimed is approximately $164,550 for both ships. NAVSEA 08 review indicates that the problem resulted from loss of [redacted] flow caused by defective performance of the electrical power supply to [redacted] pumps. The electrical power supply is shipbuilder, not Government, furnished.

- The Contractor claims 13.5 hours delay in testing on the basis that, "[redacted] plant fill [was] delayed due to inability to obtain [redacted] specified by Government furnished information. JIG Agreements 562 and 563 issued to commence plant fill with a relaxed [redacted] requirement." The requested increase in target cost claimed is approximately $111,000 for both ships. The Contractor implies that Government furnished information was over-specified. In fact, the Government, at the Contractor's request, relaxed the requirement in question on a one time only basis for CVN 68. The test procedure was not permanently changed, and the [redacted] requirement is essentially the same for all nuclear surface ships. Also, NAVSEA [redacted] noted that inability to achieve [redacted] was apparently due to a [redacted] valve located in the shipbuilder-furnished [redacted] system. Use of this valve was discontinued on follow plants (both CVN 68 and CVN 69) and the originally required [redacted] was met for those plants.

- The Contractor claims 25 hours of testing delay due to "Spare [redacted] pumps bolt hole misalignment problem. Government furnished equipment. Testing sequence modified as proposed by Contractor in an attempt to minimize effect of delay on mandatory path test sequence." The requested target cost increase claimed is approximately $205,700 for both ships. This item implies that a government furnished pump caused the misalignment problem. In fact, the pump was not defective; the misalignment problem arose from shipbuilder furnished piping to be connected

[redacted]

[redacted]

with the GFE pump. The only documented problem associated with the GFE pump concerned a flange bolt hole which required thread refurbishment as a result of a Contractor's tradesman error during pipe fit-up. Since this problem arose from poor shipbuilder workmanship, it too is the shipbuilder's responsibility. The GFE pump was not defective when furnished to the Contractor.

11. Reference (f) defines fraud as any willful means of taking or attempting to take unfair advantage of the Government including, but not limited to, deceit either by suppression of the truth or misrepresentation of a material fact. Reference (f) requires any person in the Naval establishment who has knowledge of possible fraud to report such knowledge to appropriate authorities.

H. G. Rickover

Copy to: (With enclosure)

Inspector General, Naval Sea Systems Command (NAVSEA 00N)
Chairman, Navy Claims Settlement Board (NAVMAT 00X)

[redacted]

[redacted]

NAVSEA 08 Comments on Selected Specific Newport News'
Allegations Contained in Claim Item 4.1.1,
"Government Responsible Delay - USS NIMITZ (CVAN 68)"
Submitted by Newport News Under Contract N00024-67-C-0325

[redacted]

Enclosure (1) with attachme

[redacted]

INDEX

Allegations Addressed		Amount of Delay Claimed (in hours)
1.	4.1.1.1.F	9.5
2.	4.1.1.2	456
3.	4.1.1.3.E	93
4.	4.1.1.4.C	25
5.	4.1.1.6.D	9.5
6.	4.1.1.6.G	13.5
7.	4.1.1.7.J	25.5
8.	4.1.1.9.J	68
9.	4.1.1.9.M	30
10.	4.1.1.9.N	20.5
11.	4.1.1.9.Q	20
12.	4.1.1.9.S	15.5
13.	4.1.1.9.U	7
14.	4.1.1.9.W	12
15.	4.1.1.9.Z	68
16.	4.1.1.9.AA	4
17.	4.1.1.9.AC	19.5
	Total	896.5 (37.35 days[1])

Note:

1. For the 123 days delay claimed for CVN 68 in Claim Item 4.1.1., Newport News requests an adjustment to contract target cost of $15,474,511; this represents a requested contract target cost adjustment of about $125,809 for each delay day claimed. For 731 days delay claimed for CVN 69 in Claim Item 4.1.2, Newport News requests an adjustment to contract target cost of $52,399,181; this represents a requested contract target cost adjustment of about $71,682 for each delay day claimed. Claim Item 4.1.2 alleges that each delay in CVN 68 caused a delay in CVN 69. Therefore, the adjustment in target cost claimed for both ships a result of the items discussed herein is approximately $7.3 million, exclusive claimed disruption and financing costs.

[redacted]

[redacted]

(1) Item 4.1.1.1.F

Contractor Allegation:

"Coolant [redacted] system flush No. 6 delayed because of inadequate Government furnished instructions. (Advance change notice to the reactor plant manual issued.)"

Period Claimed:

FROM 0040 11-9-73
TO 1035 11-9-73

Delay Claimed:

9.5 hours

NAVSEA 08 Comment:

The Contractor's allegation of inadequate Government furnished instructions is misleading. An advance change notice (ACN) to the Government-furnished reactor plant manual necessary to complete the [redacted] system flush was received by the Contractor approximately 4 hours prior to commencement of the test, as documented in the shift test engineer log. The shift test engineer log also indicates that the shipbuilder, between the hours 0220 and 0700, was performing a valve lineup in support of the system flush. (This was required before flush was to begin.) At 0640, the shift test engineer received the required ACN. The start of the flush was not delayed by the ACN. Thus, the Government was not responsible for delay of [redacted] system flush.

(2) Item 4.1.1.2 (Preparation for Hot Operations)

Contractor Allegation: See attachment #1.

Period Claimed:

FROM 11-26-73
TO 12-17-73

Delay Claimed:

19 days

[redacted]

[redacted]

NAVSEA 08 Comment:

This claim item does not correlate cause and effect but merely identifies three specific problems generally alleging that the three problems caused a total 19-day Government responsible delay in sequential path to ship delivery. The three problems cited relate to (1) [redacted] pump vibration; (2) pipe hangers; and (3) [redacted] pump noise.

In connection with the [redacted] pump vibration problem, installation and testing of [redacted] pump sway brace [redacted] was completed by 10 December 1973. The work on the sway braces was scheduled so as not to interfere with controlling path work. This sway brace was fabricated and installed under the shipbuilding contract which required sway braces if vibrations were a problem. Testing of the pump with sway brace installed was performed under HMR 313 which was adjudicated in February, 1974, and specifically stated that the work associated with pump testing would result in no delay in ship delivery. Therefore, the Contractor has no basis for now claiming delay.

The claim item also discusses a pipe hanger problem. The claim alleges that in November 1973, several of the pipe hangers which are required to be installed prior to hot operations had to be redesigned and that, as a result, testing was delayed. In fact, these hangers were completed and installed by 14 December 1973. Installation of these hangers was not on the controlling path. The Contractor was not ready to commence hot operations until three days later, 17 December 1973; the hanger problem was not responsible for any delay in hot operations.

Concerning the [redacted] pump noise problem, the Contractor alleges that an abnormal noise [redacted] was investigated; that the investigation required approximately 24 hours to perform; and that the Government is responsible for the resulting delay. The Contractor fails to note that the investigation was conducted concurrent with the shipbuilder's preparations for hot operations. Therefore, no delay was incurred.

In summary, the interval between completion of cold operation [redacted] and commencement of hot operations was not extended by 19 days because of Government-furnished information or equipment problems, contrary to the shipbuilder's allegations.

[redacted]

[redacted]

The actual lead plant controlling path work during this period was completion of required testing and work on over 700 incomplete shipbuilder responsible work items, including some major items such as lagging of the steam generating system, before hot operations could commence.

(3) Item 4.1.1.3.B

Contractor Allegation:

"Design evaluation of auxiliary exhaust system after operation of unloader valve [redacted] required installation of vacuum breakers and extensive system flushing. Inadequate Government responsible system design Course of Actions 85, 86, 88, 90, and JTG Agreement 394 issued. (20.5 hours of concurrent [redacted] hydraulic valve operations not included in this assessment. See following assessment.)"

Period Claimed:

FROM: 1145 1-05-74
TO : 1145 1-10-74

Delayed Claimed:

93 hours

NAVSEA 08 Comment:

The claim erroneously purports that the auxiliary exhaust system is a "Government responsible system design." In fact, the auxiliary exhaust system is a shipbuilder responsible design; therefore, the shipbuilder is responsible for any delay associated with the design.

(4) Item 4.1.1.4.C

Contractor Allegation:

"Spare [redacted] pump bolt hole misalignment problem. Government furnished equipment. Testing sequence modified as proposed by Contractor in an attempt to minimize effect of delay on mandatory path test sequence."

Period Claimed:

FROM: 0820 2-16-74
TO : 1130 2-17-74

[redacted]

[redacted]

Delay Claimed:

25 hours NOTE: Delay time of 25 hours was calculated by deducting time spent to perform test procedure 2-A/B-6, Section 5.16 from the total number of hours in this time period.

NAVSEA 08 Comment:

The claim apparently contends the GFE pump caused the misalignment problem. In fact, the GFE pump was not defective; the misalignment problem concerned shipbuilder furnished piping to be connected to the Government furnished pump. Thus, this problem is shipbuilder responsible. The only documented problems with the pump itself concerned a flange bolt hole which had to have its threads refurbished as a result of a tradesman working with the piping fit-up. Since this problem resulted due to shipbuilder workmanship, it too, is the shipbuilder's responsibility. There was nothing wrong with the GFE pump as furnished. Information concerning the piping fit up problem is documented in the after plant shift test engineer log for 16 February 1974.

(5) 4.1.1.6.D

Contractor Allegation:

[redacted] instrument system functioning improperly [redacted]. Government furnished equipment. JTG Agreements #552 and #553 issued and performed."

Period Claimed:

FROM: 2358 9-2-74
TO : 0421 9-3-74
and
FROM: 1238 9-3-74
TO : 1745 9-3-74

Delay Claimed:

9.5 hours

[redacted]

[redacted]

NAVSEA 08 Comment:

The alleged improper functioning of the GFE [redacted] instrumentation was not the cause of the problem. The real problem concerned a malfunction in a power supply which was shipbuilder responsible. The Government furnished equipment was not the affliction, but merely the symptom. There was nothing wrong with the GFE [redacted] instrumentation. In fact, JTG agreement No. 553, which is noted in the claim, identifies the shipbuilder's power supply as the cause of the problem.

(6) Item 4.1.1.6.G

Contractor Allegation:

"Primary plant fill delayed due to inability to obtain [redacted] specified by Government furnished information. JTG Agreements 562 and 563 issued to commence plant fill with a relaxed [redacted] requirement."

Period Claimed:

FROM: 2046 9-11-74
TO : 1715 9-12-74

Delay Claimed:

13.5 hours

NAVSEA 08 Comment:

The Government, at the request of the shipbuilder, relaxed the requirement [redacted] on a one time only basis for the CVN 68. The test procedure was not permanently changed, as the original [redacted] requirement is essentially the same on all nuclear surface ships. In addition, NAVSEA [redacted] noted that the inability to achieve [redacted] was apparently due to a [redacted] valve located in the shipbuilder-provided [redacted] system. The use of this valve was discontinued on follow plants and the test procedure requiremnnt [redacted] was met.

Thus, the [redacted] requirement was not over-specified by the Government, as demonstrated by the fact it was met on the follow CVN 68 plant and both CVN 69 plants, and it appears that a shipbuilder responsible system caused the problem [redacted]

[redacted]

[redacted]

(7) Item 4.1.1.7.J

Contractor Allegation:

"Additional testing of [redacted] valves [redacted] required due to replacement of original defective Government furnished valves. ACN issued to [redacted] valve technical manual."

Period Claimed:

FROM: 1055 10-23-74
TO : 1223 10-24-74

Delay Claimed:

25.5 hours

NAVSEA 08 Comment:

The Contractor's allegations conflict with the facts. Test procedure [redacted] required that the [redacted] valves be operationally tested and set to correct pressure. This Test Procure (T/P) was performed and 7 of the 8 valves had unsatisfactory set points. Although the T/P required the shipbuilder to reset and retest valves showing unsatisfactory test points he chose not to perform the retest at that time, as the [redacted] filter was showing indications of restricting flow which would necessitate a possible early cooldown from hot operations. The shipbuilder requested that the Government evaluate the data taken and inform the Contractor of any action required as a result of this review.

The Government [redacted] accepted the test "as is" (i.e., the Government excused the shipbuilder from performing the required retest) for four of the [redacted] valves but instructed the shipbuilder to reset and retest the other three valves as required by the T/P. The three valves were subsequently retested during hot operation [redacted] No valves were replaced. No GFE was faulty. The tests were merely postponed for the convenience of the parties involved.

(8) Item 4.1.1.9.J

[redacted]

[redacted]

Contractor Allegation:

"A delay in testing occurred whenever [redacted] pumps [redacted] malfunctioned, due to extended inoperative time of the equipment, [redacted] was repacked, the air poppett valve and limit switches were readjusted. Valve operational checks were made prior to startup [redacted] Startup [redacted] was made in accordance with COA 664."

Period Claimed:

FROM: 0953 1-1-75
TO : 0610 1-4-75

Delay Claimed:

68 hours

NAVSEA 08 Comment:

This claim item concerns shipbuilder-responsible delay. The [redacted] pump and [redacted] valve [redacted] are shipbuilder furnished equipment, not GFE. It is interesting to note that this claim item does not actually state that this equipment is GFE; however, in item 4.1.1.9.W. the Contractor implies that they are. The allegation that delay resulted "due to extended inoperative time" of the [redacted] pumps is not substantiated; immediately prior testing indicates the pumps were operating satisfactorily. In addition, the pumps sucessfully completed all tests prior to initial criticality. In any case, as noted above the [redacted] pumps are CFE, not GFE.

(9) Item 4.1.1.9.M

Contractor Allegation:

Testing was delayed as a result of the loss of [redacted] flow to the Government furnished steam generators

Period Claimed:

FROM: 2250 1-7-75
TO : 0515 1-9-75

Delay Claimed:

30 hours

[redacted]

[redacted]

NAVSEA 08 Comment:

This claim item is misleading. The Contractor fails to note that the shipbuilder-furnished [redacted] pumps which supply [redacted] flow to the Government furnished steam generators stopped running and caused the loss of [redacted] flow. The problem is not attributable to the Government furnished steam generators. The shipbuilder-furnished [redacted] pumps authomatically shut down as a result of a loss of pressure in the auxiliary exhaust system, also a shipbuilder responsible system. The Contractor is completely responsible for any delay that resulted.

(10) Item 4.1.1.9.N

Contractor Allegation:

"Delay in going to [redacted] power pending JTG concurrence on the method of determining the actual differential pressure across [redacted] pump strainers (Government furnished information)."

Period Claimed:

FROM: 0345 1-10-75
TO : 1400 1-10-75

Delay Claimed:

20.5 hours

NAVSEA 08 Comment:

The Contractor's claim item is misleading; Government furnished information is not involved. The Joint Test Group (JTG)—which includes Contractor and Government representatives and whose decisions must be unanimous—would not agree to proceeding to [redacted] power until the shipbuilder could assure the JTG that he was taking accurate and reliable data on the [redacted] pumps differential pressure gages, as required by the test procedure. Prior data taken with the gages and procedures (developed by the shipbuilder) then in effect had been erratic and did not appear reliable. Additionally, the shipbuilder's test personnel did not know how to obtain and calculate the required data. After a review, the Contractor proposed and the JTG technically concurred with changing the gages and the method of obtaining meaningful data to satisfy the test procedure requirements. The gage arrangement was shipbuilder-provided. The Government only required that [redacted] pump differential pressure data be recorded accurately, but not how to collect the data. The earlier shipbuilder method was clearly not adequate as evidenced by the Contractor's recommendation to change it. In addition, it is noted that the amount of delay claimed (20.5 hours) does not

[redacted]

correspond to the period claimed, since 0345 to 1400 is equal to 10.25 hours.

(11) Item 4.1.1.9.Q

Contractor Allegation:

"Section 5.12 of Test Procedure 3-KA-23 was delayed as a result of the loss of coolant flow (unsatisfactory performance of GFE). After performing COA's 274 and 275 the reactor was returned to criticality."

Period Claimed:

FROM: 1154 1-15-75
TO : 0815 1-18-75

Delay Claimed:

20 hours

NAVSEA 08 Comment:

The Contractor's allegation concerning "unsatisfactory performance of GFE" is misleading. The defective equipment, the electrical power supply to [redacted] [redacted] pumps which maintain [redacted] flow, is furnished by the shipbuilder, not the Government. [redacted] flow was lost when the power supply to the [redacted] pumps was lost forcing the [redacted] pumps to shutdown. There was nothing wrong with the GFE [redacted] pumps.

(12) Item 4.1.1.9.S

Contractor Allegation:

[redacted] tests were delayed after the [redacted] pumps tripped off the line due to low [redacted] pressure (unsatisfactory performance of GFE)."

Period Claimed:

FROM: 1526 1-21-75
TO : 0700 1-22-75

Delay Claimed:

15.5 hours

[redacted]

[redacted]

NAVSEA 08 Comment:

The Contractor's claim is misleading. The Contractor contends that the loss of [redacted] constitutes "unsatisfactory performance of GFE." Apparently, the Contractor is alleging that the [redacted] pumps are Government-furnished. In fact, the feed system is a shipbuilder design system. All equipment comprising this system, including the [redacted] pumps, is shipbuilder furnished. No GFE or GFI were involved. The shipbuilder is responsible for proper operation of the feed system. The problems were completely the responsibility of the shipbuilder.

(13) Item 4.1.1.9.U

Contractor Allegation:

"Return to power was delayed due to the requirement of JTG Course of Action #594-284 to take steam plant [redacted] analysis data, which was part of the work involved with unadjudicated HMR 360."

Period Claimed:

FROM: 2230 1-24-75
TO : 0518 1-25-75

Delay Claimed:

7 hours

NAVSEA 08 Comment:

Additional samples of the [redacted] system were analyzed by the shipbuilder and ship's force in attempting to locate the source of [redacted] present to the shipbuilder's steam plant [redacted] The [redacted] level was out of specification. The Government was concerned that the high concentration [redacted] entering the steam generators would be detrimental to the steam generators (accelerated corrosion) if the required test procedure, [redacted] was performed prior to reducing [redacted] content to normal levels. HMR 360 did not concern this problem in any way, contrary to the allegations in the Contractor's claim.

The responsibility for this problem is completely the shipbuilder's since a shipbuilder-responsible system was out of specification.

[redacted]

[redacted]

(14) Item 4.1.1.9.W

Contractor Allegation:

"As a result of low [redacted] pump suction pressure (unsatisfactory performance of GFE) there was a loss of [redacted] flow and [redacted] testing was delayed. The Government's vendor replaced the Auxiliary Exhaust system augmenting valve operators operationally checked and set prior to returning to power."

Period Claimed:

FROM: 1335 1-27-75
TO : 0130 1-28-75

Delay Claimed:

12 hours

NAVSEA 08 Comment:

The [redacted] pumps are not government furnished equipment. These pumps are provided by the shipbuilder. The auxiliary exhaust system is a shipbuilder design and all components are furnished by the shipbuilder. The reference to the "Government's vendor" is not accurate. This vendor is subcontracted by the shipbuilder.

(15) Item 4.1.1.9.Z

Contractor Allegation:

"[redacted] testing was delayed as a result of the loss of steam [redacted] (unsatisfactory performance of GFE), [redacted] An investigation of the [redacted] tank was made. COA 292 which investigated the auxiliary exhaust system augmenting valves settings was completed."

Period Claimed:

FROM: 0335 1-31-75
TO : 2300 2-02-75

Delay Claimed:

68 hours

[redacted]

NAVSEA 08 Comment:

Apparently, the Contractor contends that the loss of steam [redacted] constitutes unsatisfactory performance of Government furnished equipment, when, in fact, the [redacted] system is a shipbuilder-furnished design and all equipment installed in this system is also shipbuilder furnished. Since the shipbuilder is responsible for proper operation of the [redacted] system, the [redacted] tank, and the auxiliary exhaust system and no GFE or GFI is involved, the problems encountered were completely the Contractor's responsibility.

(16) Item 4.1.1.9.AA

Contractor Allegation:

"Dock trials were delayed as adjustments were required to be made on the throttle control system. The synchro receiver and servo valve linkage were realigned as discussed in Proposal Section 3.1.4."

Period Claimed:

FROM: 0905 2-3-75
TO : 1300 2-3-75

Delay Claimed:

4 hours

NAVSEA 08 Comment:

The alleged delay is not the responsibility of the Government; the throttle control system is a shipbuilder furnished system. The shipbuilder is responsible for proper operation of this system.

(17) Item 4.1.1.9.AC

Contractor Allegation:

"[redacted] failed [redacted] due to extended inoperative time of the equipment. The valves limit switches and the poppetts were readjusted. The auxiliary exhaust system augmenting valves were set and operationally checked."

[redacted]

Period Claimed:

FROM: 0658 2-7-75
TO : 0732 2-8-75

Delay Claimed:

19.5 hours

NAVSEA 08 Comment:

The Government is not responsible for the alleged delay, since the [redacted] valve [redacted] and the auxiliary exhaust valves are shipbuilder furnished components. The shipbuilder is solely responsible for proper operation of these components. In addition, the Contractor's allegation that the [redacted] valve failed due to an extended inoperative period is not substantiated. This valve had operated satisfactorily during [redacted] testing just prior to the [redacted] procedure.

[redacted]

EXHIBIT E

JANUARY 3, 1978 -- LETTER FROM NAVSEA 08 (RICKOVER) TO SECRETARY OF THE NAVY

DEPARTMENT OF THE NAVY
NAVAL SEA SYSTEMS COMMAND
WASHINGTON, D.C. 20362

[redacted]

IN REPLY REFER TO

3 January 1978

From: Deputy Commander, Nuclear Propulsion Directorate (NAVSEA 08)
To: Secretary of the Navy

Subj: Newport News Claim Under CVN 68 Class Construction Contract N00024-67-C-0325; Claim Item 4.1.2, "Government Responsible Delay—USS DWIGHT D. EISENHOWER (CVAN 69)"

Ref:
(a) My letter of 19 May 77 to NAVMAT 00X and NAVSEA 00N
(b) My letter of 14 Jul 77 to NAVMAT 00X and NAVSEA 00N
(c) My letter of 1 Nov 77 to NAVMAT 00X and NAVSEA 00N
(d) My letter of 18 Nov 77 to NAVMAT 00X and NAVSEA 00N
(e) My letter of 10 Dec 77 to NAVSEA 00N and ASN(MRA&L)
(f) My letter of 30 Dec 77 to SECNAV
(g) NAVSEAINST 5371.1 of 11 Dec 74

Encl: (1) Figure 4.1-1, page 4-3 of Vol. II, Book 8 of 10 of Newport News Claim under CVN 68 Construction Contract N00024-67-C-0325

1. By references (a) through (f), in accordance with reference (g), I have brought to the attention of appropriate Naval authorities numerous items from the claims submitted by Newport News and Electric Boat which appear to be attempts by these companies to make the Government pay money it does not owe. I pointed out to you in reference (f) that these reports describe items in the Newport News and Electric Boat claims which are examples of:

- Statements which are demonstrably untrue.
- Statements apparently designed to mislead.
- Withholding of documents which would disprove allegations of Government responsibility.
- Alleged Government responsibility for costs which are the shipbuilder's responsibility under the contract.
- Claims for costs that have already been reimbursed.
- Claims for costs which have not or will not be incurred.

2. In reference (f), among other things, I reported that Claim Item 4.1.2, "Government Responsible Delay—USS DWIGHT D. EISENHOWER (CVAN 69)", submitted by Newport News under the contract to construct three NIMITZ Class aircraft carriers (CVN 68-70) may warrant investigation for possible violation of

[redacted]

[redacted]

[redacted]

fraud or false claims statutes. The purpose of this letter is to report additional reasons why that claim item should be investigated for violation of possible fraud or false claims statutes.

3. In Claim Item 4.1.2, "Government Responsible Delay—USS DWIGHT D. EISENHOWER (CVAN 69)", Newport News at the time of claim submission in February 1976 projected a ship delivery date of 30 June 1977 and alleged that the Government was responsible for all of the 731 calendar days of delay beyond the original definitized contract delivery date of 30 June 1975. The total increase in contract ceiling price claimed for the CVN 69 is $121 million, of which $70 million is for delay.

4. In Section 4.1.2.1, "Causes of Delay", Newport News alleges that the CVN 69 was delayed due to Government responsible delay to the CVN 68; Government responsible expansion of the work on CVN 69; manpower resource problems which resulted from alleged Government responsible delays on the CVN 68; and due to "the physical resource constraint imposed on the Contractor on the initial construction of CVN 69 by CVN 68 delay." No attempt is made in the claim to allocate the $70 million in ceiling price adjustment claimed for delay among the alleged causes of delay. Concerning "the physical resource constraint" the claim states:

> "...The pre-launch construction activities on both vessels were scheduled to take place in Shipway 11, the only non-Government building dock in the United States capable of handling the complete CVAN 68 Class hull construction effort. From an earlier schedule, Schedule "A" (Figure 4.1-1, page 4-5), it can be seen that the CVAN 68 launching and CVAN 69 keel laying were both scheduled for July, 1970. CVAN 68, scheduled to be launched in October, 1971 by the definitized schedule, was not launched until May, 1972. This represents a 7-month delay which affected construction on CVAN 69. As originally planned, when CVAN 68 was launched, CVAN 69 was planned to replace it in Shipway 11. However, due to the problems encountered in CVAN 68 construction, CVAN 69 could not be placed in Shipway 11. To mitigate the effects, the Contractor revised his planning and began construction of CVAN 69 in Shipway 9. CVAN 69 was in Shipway 9 from August, 1970 until September, 1972 and then was transferred to Shipway 11 to complete all pre-launch work by October, 1975 for the present launch schedule.

[redacted]

[redacted]

[redacted]

> "The limitations of Shipway 9 imposed severe restrictions on the amount of work which could be done on CVAN 69 due to physical limitations of the shipway, i.e., size, weight, crane facilities, and the like. Only the mid-section of CVAN 69 from frame 96 to frame 180 could be built on Shipway 9. Furthermore, only sections of the ship below the 3rd deck and inboard of the longitudinal ballistic bulkheads could be assembled on Shipway 9 (the photograph on the opposite page shows the mid-section of the CVAN 69 as it was nearing completion). This section was moved to Shipway 11 on September 9, 1972. Figure 4.1-13 shows the relationship which the mid-section of the ship which was constructed on Shipway 9 bears to the overall hull construction effort. The limitations on the construction effort imposed by the necessity to begin construction in Shipway 9 instead of Shipway 11 are obvious. CVAN 69 was scheduled to be transferred from Shipway 9 to Shipway 11 in May, 1972, after CVAN 68 was launched; it was not transferred until September, 1972. Hence, it was not until September, 1972 that the construction program got into full swing and construction sequences approximating normality could be utilized. (Emphasis added.)"

5. I believe that any person reading the above quotation from the claim would be led to believe that:

- Newport News originally intended to lay the keel of CVN 69 in Shipway 11 after launching the CVN 68.
- That Schedule "A" in Figure 4.1-1, page 4-3, would show that both these events were at one time scheduled for July 1970.
- That the keel of CVN 69 could not be laid in Shipway 11 "due to the problems encountered in CVN 68 construction."
- That Newport News began construction of CVN 69 in Shipway 9 because of these problems.
- That the physical limitations of Shipway 9 caused delays in the construction of CVN 69.

6. If so, the reader would be misled on each and every point. The facts are that:

- Newport News originally planned to lay the keel and start assembly of CVN 69 in Shipway 10, a graving dock, next to Shipway 11.
- This plan was in effect from the earliest

[redacted]

[redacted]

consideration of construction of the CVN 69 as follow ship to the CVN 68 up through March 1970.

- In April 1970, two months before Newport News signed the definitized contract for CVN's 68 and 69, Newport News decided to start construction of the CVN 69 on Shipway 9, an inclined building way.

- Newport News started construction of CVN 69 on Shipway 9, in lieu of Shipway 10, in order to make the Shipway 10 graving dock available for commercial ship work.

- At the time Newport News decided to start construction of CVN 69 on Shipway 9 in lieu of Shipway 10, Newport News assured the Navy that the cost of initial construction on the inclined way would be no greater than if the construction were done in the Shipway 10 graving dock.

- Newport News had used the same approach in the initial stages of construction of the conventional carrier, JOHN F. KENNEDY (CVA 67). Page III-47 of the KENNEDY claim contains the following statement:

  > "When subassembly work has proceeded sufficiently to support a continuing erection effort, the keel is laid. Since the graving dock is in great demand, various schemes are made to shorten the time it is occupied. For example, the keel for CVA-67 was laid on an inclined building way, and construction proceeded there for seven months until the machinery box was built (ie. the 280 ft. length between frames 93 and 163, up to 4th deck and out to the second longitudinal bulkhead). This section of the ship was then launched and landed on building blocks in the graving dock where construction proceeded until launch."

- Figure 4.1-1, which is included in an entirely different volume of the EISENHOWER claim, is attached as Enclosure (1). That figure shows, contrary to the statement from the claim quoted above, that Schedule "A" for the EISENHOWER called for its keel to be laid on 30 March 1970. The figure also shows that when that schedule was issued on 9 December 1969—more than five months before Newport News signed the letter contract for construction of the CVN 69—Schedule D for the NIMITZ had already been issued; this showed

[redacted]

[redacted]

[redacted]

the NIMITZ launch scheduled for 15 May 1971. Thus, even at that time, Newport News was scheduling the keel of the EISENHOWER to be laid over 13 months before the launch of the NIMITZ from Shipway 11.

- At the time the NIMITZ was actually launched from Shipway 11, on 13 May 1972, work on the CVN 69 in Shipway 9 had not proceeded to the point where it could be launched.

- At the time the initial section of the CVN 69 was launched from Shipway 9 in September 1972, Newport News had not completed as much work as they originally planned to complete on Shipway 9.

7. I note that the Navy claims analysts responsible for reviewing Claim Item 4.1.2 concluded that the Government is responsible for very little, if any, of the 731 days delay alleged to be a Government responsibility in this claim item.

8. I recommend that Claim Item 4.1.2 be thoroughly investigated to determine if all or any part of the $70 million increase in ceiling price requested by this item represents a violation of false claims or fraud statutes. Such an investigation should, of course, include interviews of present and former Contractor personnel familiar with the actual facts. I recommend that those to be interviewed include W. R. Phillips, D. E. Kane, H. L. Sutton, Jr., W. B. Huffleton, Jr., L. F. Bledsoe, A. O. Winall, W. J. Burn[illegible] R. J. Baumler, N. S. Plummer, J. E. Turner, and G. M. Bennett, [illegible] well as those who wrote the claim item.

9. The facts cited above are just one example of the grossly misleading nature of much of the material in the Newport News claims. I do not see how any objective person could be aware of the great disparity between the facts and the Newport News allegations and not conclude that the Newport News shipbuilding claims may be a "willful means of taking or attempting to take unfair advantage of the Government including, but not limited to, deceit either by suppression of the truth or misrepresentation of a material fact."

10. Reference (g) defines such an act as fraud and requires any person in the Naval establishment who has knowledge of possible fraud to report such knowledge to appropriate authorities.

H. G. Rickover
H. G. RICKOVER

Copy to: (With enclosure)
NAVSEA OON
NAVMAT OOX

[redacted]

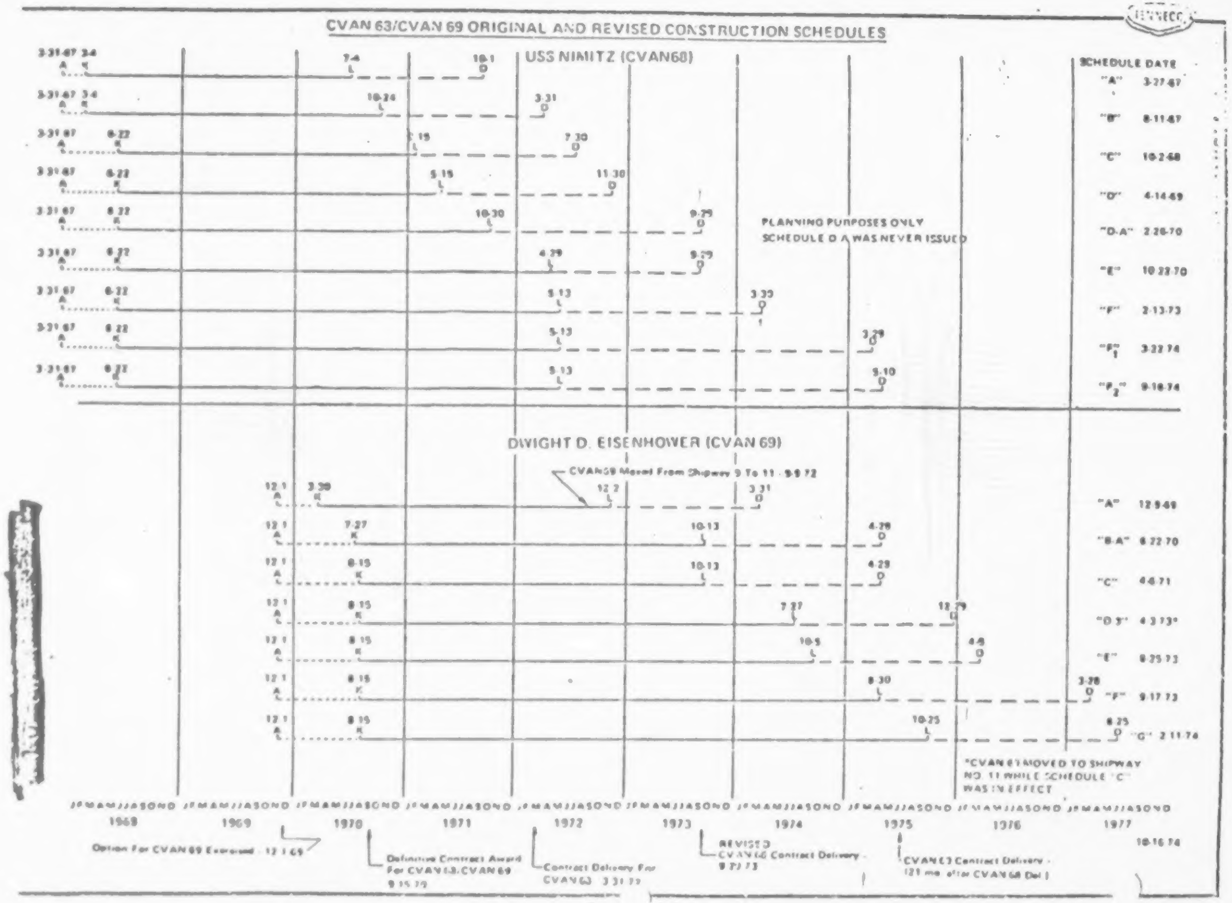

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EXHIBIT F

JANUARY 5, 1978 -- LETTER FROM NAVSEA 08 (RICKOVER) TO SECRETARY OF THE NAVY

[redacted]

⑤

DEPARTMENT OF THE NAVY
NAVAL SEA SYSTEMS COMMAND
WASHINGTON, D.C. 20362

[redacted]

IN REPLY REFER TO
5 January 1978

From: Deputy Commander, Nuclear Propulsion Directorate (NAVSEA 08)
To: Secretary of the Navy

Subj: Newport News Claim Under CVN 68 Class Construction Contract N00024-67-C-0325; Claim Item 3.2.8, "Nuclear Discrepancy Reports"

Ref:
(a) My letter of 19 May 77 to NAVMAT 00X and NAVSEA 00N
(b) My letter of 14 Jul 77 to NAVMAT 00X and NAVSEA 00N
(c) My letter of 1 Nov 77 to NAVMAT 00X and NAVSEA 00N
(d) My letter of 18 Nov 77 to NAVMAT 00X and NAVSEA 00N
(e) My letter of 10 Dec 77 to NAVSEA 00N and ASN(MRA&L)
(f) My letter of 30 Dec 77 to SECNAV
(g) My letter of 3 Jan 78 to SECNAV
(h) NAVSEAINST 5371.1 of 11 Dec 74

Encl: (1) Preliminary Claim Item Technical Analysis Report 3.2.8, "Nuclear Discrepancy Reports"

1. In my testimony to the Defense Subcommittee of the House Appropriations Committee on 24 March 1977, (enclosure (7) to reference (b)) and in references (a) through (g), I reported numerous items which illustrate various techniques used by Newport News and Electric Boat in their shipbuilding claims to get the Government to pay money which Navy analysis shows is not owed.

2. This letter reports a claim item which illustrates another technique Newport News has used to claim that the Government is responsible to pay costs for work which is actually the Contractor's responsibility. I refer specifically to Claim Item 3.2.8, "Nuclear Discrepancy Reports," submitted by Newport News under the contract to construct three NIMITZ Class aircraft carriers. The NAVSEA-08 Preliminary Claim Item Technical Analysis Report for this claim item is attached as enclosure (1). Newport News has also submitted claims on nuclear discrepancy reports under the two contracts for construction of the nuclear cruisers CGN 36-41. These items request a total increase in ceiling prices on the three contracts of about $12 million.

3. As summarized in this letter, and discussed in detail in enclosure (1), the subject claim item is an example of how Newport News has attempted to shift to the Government responsibility to pay for increased costs which resulted from the company's inability to hire and train sufficient manpower to carry out its contractual commitments. In its claims, Newport News alleges that the Government is responsible for the large increase in

[redacted] [redacted]

[redacted] [redacted]

the number of reports by company inspectors of discrepant nuclear work by company personnel which occurred during periods of labor turbulence. The following paragraphs explain why I believe the techniques illustrated by Claim Item 3.2.8 may constitute a violation of fraud or false claims statutes.

4. In comments furnished for the record of the March 1977 Defense Subcommittee hearings, I pointed out that the Navy had initiated an in-depth production analysis to assess the impact of Newport News' manpower problems on ship construction performed under the six shipbuilding contracts against which Newport News has submitted claims for ceiling price increases of about $894 million, but that Newport News has refused to furnish data which would facilitate completion of the analysis. Booze Allen Applied Research is doing the analytical work under contract with the Navy; to date $2.9 million has been committed to this study. Preliminary reports prepared by Booze Allen confirm that the inability of Newport News to acquire the quantity and skill of workers projected by Newport News to be necessary to meet their contractual commitments was a significant factor in the labor cost growth and schedule stretch-out on the ships included in the six contracts. Newport News' refusal to furnish the requested data may indicate the company is fearful that the facts would undermine their claims.

5. The manpower problems in question resulted from Newport News' attempts to expand their labor force in the early 1970's. Newport News projected in 1971 and 1972 that then existing contracts would require a build-up in manpower from a low of 18,200 employees early in 1971 to over 30,000 in 1973. By the time the Newport News manpower expansion reached a level of about 28,000 employees in early 1973, the company found that the dilution of the skill level of their overall work force, together with the declining ability of the new hires, caused a large reduction in productivity and a large increase in the number of fabrication errors, as well as a high employee turnover rate. For example in 1972-1973, Newport News hired more than 18,000 people, but during this same period about 17,000 people left the company, resulting in a net increase of a little over 1,000 in this two-year period. Also, the company had great difficulty in retaining or hiring skilled craftsmen. The ratio of skilled to unskilled craftsmen increased from about 3/1 in 1968 to 9/1 at the end of 1970 due to unskilled worker layoffs, but then fell to about 2/1 by late 1971 during the subsequent labor expansion.

6. The claims submitted by the company involve six contracts for 14 nuclear powered ships. These contracts were placed over the period 1968-1971. Each of these six contracts is a fixed-price, incentive-fee type contract. A contract of this type sets a target cost, a target profit, and a ceiling price, and provides that the Government and the Contractor share in overruns beyond target cost up to the contract ceiling price. Costs exceeding the ceiling price are borne by the shipbuilder unless he can

[redacted] [redacted]

[redacted]

[redacted]

demonstrate such costs are the Government's contractual responsibility. Pricing of three of the contracts was negotiated on a sole-source basis; pricing of one of the contracts was negotiated with two shipbuilders bidding; and pricing of two of the contracts was accepted on a competitive bid basis among three bidders with no negotiation. For each of the six contracts, the target cost mutually agreed to was greater than the Navy's estimate of what the cost to do the work should be, based on prior returns for similar work at Newport News.

7. The manpower problems cited above increased costs. Declining productivity and increased rework necessary to correct construction errors increased the manhours required to complete Navy contracts beyond the company's expectations when the contracts were signed. Also, faced with the inability to obtain a labor force of the desired size and skill level necessary to meet their commitments on existing Navy contracts, Newport News stretched out Navy ship construction schedules. In an inflationary economy, the net result was to perform work at a later, more expensive time. Under the terms of the contracts, these manpower problems are the Contractor's responsibility.

8. The problems encountered by Newport News in attempting to expand its work force were well recognized at the time by senior management. For example, during the period 28 February to 3 March 1972, representatives of the Naval Ship Systems Command (NAVSHIPS) conducted a comprehensive audit of naval nuclear work at the company. By letter of 18 April 1972, the Commander, Naval Ship Systems Command, formally transmitted the audit report to the President of Newport News. This report identified numerous deficiencies in the company's control of nuclear work, including findings that material was not fabricated in accordance with drawing requirements; that incorrect materials had been used, including unauthorized substitutions of materials by production personnel; that an excessive amount of material had been lost; that reactor plant piping and equipment had been damaged due to arc strikes, nicks, and gouges; that cleanliness control procedures and practices were inadequate, and so on. For these and other deficiencies, the Commander, Naval Ship Systems Command urged that the company correct the underlying causes to prevent their recurrence.

9. By letter of 24 May 1972 and enclosures thereto, Mr. L. C. Ackerman, then Newport News President, responded to the NAVSHIPS audit. Mr. Ackerman stated that Newport News had a strong, well-developed quality control system and that analysis of the underlying causes of deficient nuclear work indicated that the primary problem was with implementation of the quality control system. He said that the primary solution could be found in requiring increased management presence on the job site, a stronger, viable audit program, and competent training of company personnel involved in naval nuclear work. In reference

[redacted]

[redacted]

to inadequate quality control of work-in-process, the enclosure to Mr. Ackerman's response stated:

> "It should be recognized that the current volume of work and the influx of new personnel to the naval nuclear program at NNSD has been a contributing factor, one well recognized by management, and increased attention is being provided to reduce the in-process fabrication errors."

10. The NAVSHIPS audit findings were consistent with the Contractor's own evaluations of discrepant nuclear work. In December 1971, the company implemented a defect prevention program by revising internal procedures to require the Contractor's Quality Inspection Department (QID) to perform periodic audits of shipyard production departments for the purpose of identifying and correcting the sources of discrepant nuclear work. The QID reports issued over the period 1971-1974 reviewed thousands of nuclear discrepancy reports (DR's) issued by the company's inspectors. According to the QID audit reports available in Government files, most discrepancies resulted from Contractor responsible problems; such as, poor workmanship, human error, inattention to detail, and so on. The following findings are quoted from these QID reports:

> "Action should be taken by (cognizant division management) to minimize the present degree of discrepant work and the quantity of material replaced and reworked."
>
> "Immediate action is required to reduce fabrication errors resulting from inattentive workmanship."
>
> "A review of these DR's revealed the discrepancies were randomly distributed over the range of material undergoing processing. Most of these rejects can be attributed to lack of attention to detail."
>
> "Immediate action is necessary to reduce the quantity of discrepancies resulting from human error."

The QID reports stressed the need for the company to take corrective actions including increased supervision, training programs, and so forth.

11. The productivity problems associated with Newport News' manpower expansion were also recognized by senior Navy officials. By letter of 7 February 1973, the Supervisor of Shipbuilding, Newport News, forwarded to Mr. Ackerman a report citing specific examples of poor productivity of Newport News workers. He said:

> "Lack of productivity of shipyard personnel working on naval ships at Newport News continues to be a matter of deep concern to me. As you know, this has been the

[redacted] [redacted]

> subject of numerous communications and discussions with you during the past year. In a letter of August 17, 1972, the shipyard President stated he had instituted a number of specific corrective actions designed to cope with this problem. Nevertheless, my observations of worker idleness in production work areas and in naval ships under construction or in overhaul since August 1972 do not indicate that improvement has been made."

12. By letter of 28 February 1973, Mr. J. P. Diesel, who joined the company in June, 1972, and replaced Mr. Ackerman as president, signed a response on behalf of Mr. Ackerman which cited specific actions taken by Newport News to increase worker productivity. The letter stated:

> "As you noted in your letter of February 7, this situation has my attention as well as Mr. Diesel's, and we have implemented both short and long range programs to improve the productivity of our work force."

13. By 1973, the deterioration of the labor force productivity had become so serious that the company abandoned its plans to increase manning to 30,000 employees. Mr. Diesel and Mr. N. W. Freeman, Chairman of the Board and Chief Executive Officer of Tenneco, called joint press conferences for the purpose of explaining the company's position. Newspaper accounts of these conferences also demonstrate that productivity problems were well recognized at the highest echelons of the company as well as its parent conglomerate. The October 5, 1973, Newport News Times Herald reported:

> "Both Diesel and Freeman blamed productivity problems for profit woes. Freeman warned, 'If we are not successful, the community is going to be vitally affected.'
>
> "Both men blamed the large recent expansion of some 10,000 people in the labor force at the yard as being a deterrent to productivity."

14. The October 6, 1973, edition of the Newport News Daily Press carried another article, entitled, "Increased Productivity Yard Goal" which stated:

> "Diesel said, 'We have developed a skilled work force and can do many things, such as build land based nuclear power plants.
>
> "He said one of the problems of productivity is that the yard expanded its work force too rapidly.

[redacted]

[redacted]

[redacted]

> "He explained the training program for workers costs about $25 million and he estimated it costs the shipyard about $25,000 to train an employee."

15. The October 7, 1973, Daily Press carried another article on shipyard productivity which stated:

> "Diesel didn't blame the drop in productivity this year on shipyard employees. He said, 'We are at fault for expanding our work force so rapidly as we did by some 10,000 people. We must find a way to train them faster.
>
> 'It, according to our figures, costs us about $25,000 to train a person. Our training bill at this time is an estimated $25 million.
>
> 'The labor force is subject to extreme peaks and valleys, which is hard on labor and the shipyard and causes the problems,' he explained."

16. Subsequent to the company's announcement in 1973 that plans to increase manning to 30,000 employees had been abandoned, the employment level decreased to a low of about 23,000 in 1975 and is presently about 25,400. However, productivity problems persisted. As late as 1975, the Daily Press carried an article reporting that on 15 February 1975:

> "Mr. Diesel made a 'strong, blunt speech' to Apprentice School alumni gathered for an annual banquet. The article says that he told those holding jobs at the shipyard to in effect 'shape up or ship out.' The article goes on to state:
>
> "The long talk was delivered forcefully by Diesel and at some points he used expletives to get his message across. The theme of declining American worker productivity is one he has turned to with increasing frequency in his speeches.
>
> "He told of a recent visit to some unnamed area of the yard several days ago 20 minutes after the workday had started.
>
> "'I want to tell you that I was lucky to find 20 percent working,' even if I gave everyone the benefit of the doubt' Diesel related.
>
> "Despite his recent announcement of yard layoffs and financial troubles, 'I still don't think people are listening to me,' he said. 'I've got a lot of heat on me right now because we have to

[redacted]

[redacted]

be more efficient. Everyone agrees and says yes but the inefficiency never occurs in their baliwick.'"

17. In late 1973 and early 1974, senior TENNECO and Newport News officials tried to convince senior Navy and Defense officials that their fixed-price-incentive-fee contracts should be reformed to cost-plus type contracts. The Chairman of the Board of TENNECO informed the Deputy Secretary of Defense that TENNECO wanted 7 percent profit on all costs after interest and before taxes. He said TENNECO would be happy to return to the Government any profit greater than this. To support their case, Newport News and TENNECO officials complained that they had been forced to accept unrealistically low target costs and unrealistically early delivery schedules in their contracts. In making these arguments, they neglected to point out that two of the contracts that were in the deepest financial trouble were competitively bid, and the prices were not negotiated at all. Further, they neglected to mention that the delivery dates for many of the ships that by then were behind schedule had been proposed by Newport News.

18. In August 1974, Mr. Diesel testified at length to the Seapower Subcommittee of the House Armed Services Committee. He blamed the Government for the cost overruns at Newport News and the delays in the ship schedules. He said that "the manpower question threatens to become a 'red herring'" and expressed concern "lest manpower become a facile shiboleth and an all too convenient explanation of shipyard delays."

19. Mr. Diesel complained of "the stultifying Government bureaucracy under which we had been forced to labor"; alleged that "unrealistic target prices are responsible in large part for the dire situation now facing the Navy's shipbuilding program"; and stated: "The Navy's 10-year pattern of coaxing, cajoling, bullying and arm-twisting shipbuilders and suppliers to take marginal, high risk, and frequently unprofitable business—all with promises of future rainbows if they acquiesce and economic disaster if they refuse—is just about over." He recommended that Newport News contracts be put on a cost-plus basis.

20. The House Seapower Subcommittee in its subsequent report made it clear that it did not agree that shipbuilding contracts should be on a cost-plus basis and that it was important to enforce Government contracts.

21. When it became clear to Newport News that the executive branch and congressional officials were not willing to reform their contracts to a cost-plus basis, Newport News assembled a large group of people to study ways to blame the Navy for cost increases. In October 1974, the company notified the Navy that they intended to submit claims against the Government on all six nuclear shipbuilding contracts, and subsequently submitted these claims from mid-1975 through early 1976.

[redacted]

[redacted]

22. In the claims, Newport News alleges that the Government is responsible to pay for all costs that have occurred, plus a substantial profit. Contrary to statements by company officials (see paragraph 27) that the original contracts were underpriced, the claims on four of the six contracts now allege that for the scope of work covered by the original contracts, Newport News' performance was so good that they underran the target costs. This is tantamount to saying that Newport News' manpower, productivity, and other problems for which the Contractor is responsible did not in fact cause overruns to the contract target costs. If the total claims were paid at face value, Newport News would recover all of their costs, including interest, on the six contracts involved, and a profit, after interest, greater than the original total target profit. In fact, the overall pre-tax profit, after interest, would be much larger than the profit objective set by TENNECO of 7 percent of total costs after paying interest.

23. An example is the claim submitted by the company under the contract for construction of the nuclear carriers CVN 68, 69, and 70. As of November, 1977, more than a month after delivery of the CVN 69, Newport News projected that without a claim they will recover all cost plus about $76 million profit for the CVN's 68 and 69, despite the significant manpower problems during the ten-year building period and the lengthy delays in ship delivery. The third carrier, the CVN 70, is being built on a cost-plus basis until the pricing for that ship is definitized.

24. Nevertheless, on 19 February 1976, Newport News submitted their largest claim, a request for an increase of $221 million in the ceiling price for the CVN 68 and CVN 69. The day after Newport News submitted this 16-volume claim, Mr. Diesel addressed a letter to the Chief of Naval Operations suggesting that Newport News might stop work on the CVN 70 until there was "a far different atmosphere" in relations with the Navy. At that time, Newport News had been working on the CVN 70 for over three years on a cost-plus basis. Since Newport News is the sole source for nuclear-powered aircraft carriers, they have repeatedly used the threat of not building the CVN 70 as leverage in contract disputes, no doubt hoping thereby to get the Navy to settle the claims quickly without taking the time necessary to analyze them thoroughly.

25. The Newport News claim against the CVN 68 and CVN 69 is particularly interesting since it is the largest Newport News claim, and the Company would recover all their costs on these ships and a profit, even without a claim. Taking contract share lines into consideration, if the claim were paid at face value, Newport News would recover about $75 million from the claim.

[redacted]

[redacted]

[redacted]

This would yield a total profit of about $101 million on the CVN 68 and CVN 69 - over $25 million more than the target profit for the original contract work plus change orders.

26. It is my understanding that during the detailed analysis of this claim over the past two years, Navy analysts have discovered that the preponderance of the $221 million increase in ceiling price claimed is invalid. I will cite a specific example which may give you some idea of how grossly inflated the Newport News claims actually are. The first internal budget for the CVN 68 and CVN 69 issued by Newport News subsequent to contract definitization was issued in April, 1971 and totaled an amount equal to the target cost. This budget allotted 943,700 manhours for nuclear engineering work to be performed on the CVN 69. The total nuclear engineering manhours actually charged to the CVN 69 to date, including all contract changes, is only about 780,000. Therefore, according to Newport News' cost accounting records, Newport News actually expended a total of 163,700 nuclear engineering manhours less than they budgeted for the original contract work in April, 1971. Nevertheless, Newport News alleges in the claim that the Government is responsible for an additional 230,000 nuclear engineering manhours for the CVN 69, or almost one-third of the total nuclear engineering manhours actually expended for the CVN 69. For this to be valid, Newport News would have had to underrun the original contract target cost in this category by over 40 percent.

27. Once the claims were submitted, Mr. Diesel started a broad campaign, which he has kept up for the past two years, "to bring all the pressure to bear that I can" to force a prompt resolution of the claims. On national television, he accused the Navy of having "knowingly and willfully underestimated the cost of nuclear ships ... under contract now." He said the Navy did this "to aid and abet the program to get all Navy ships or a high percentage of Navy ships nuclear powered. You have got to fit the nuclear powered ships within some fixed budget and if you haven't got enough money, the best way to make the budget look good is to underestimate the cost of a ship."

28. Mr. Diesel has also maintained that the claims include only the cost of Government actions, not the cost of company mistakes. Specifically, in a speech to the Warwick, Virginia, Lions Club on November 18, 1976, Mr. Diesel stated:

> "The immediate problem centers around nearly $900 million in claims against the Government for naval ship construction covering the period since 1967 --- work that we have already performed or are now performing, but have not been paid for. This work covers 14 nuclear-powered ships, seven of which are now in the fleet.

[redacted]

[redacted]

~~FOR OFFICIAL USE ONLY~~

"Some of the instant experts have characterized these claims as 'cost overruns.' This is not the case. *Sometimes we make mistakes, and our costs sometimes do exceed our estimates. But our claims against the Navy do not reflect our own errors. They include only the cost impact of Government actions,* including changes in ship design and construction ordered by the Navy and late and defective Government-furnished equipment and information." (Emphasis added)

29. The same month, in a television interview broadcast in the Newport News area, Mr. Diesel reiterated his position that the claims were for costs already incurred due to Government actions. He said the claims came about:

> "As a result of changes made in ships, of late delivery of Government furnished equipment and late delivery of Government furnished information and faulty information. One of the misnomers that I think arises in the claims area, is that these are referred to as overruns. Certainly there are overruns, there are inefficiencies, that have occurred that are our responsibility but the moneys that we are asking for are only related to those issues or items that I specified at the beginning."

30. Mr. Diesel again underscored this point in his March 23, 1977 testimony before the Defense Subcommittee of the House Appropriations Committee and in answers subsequently submitted for the record. In reference to claims submitted by the company under Naval nuclear shipbuilding contracts, Mr. Diesel stated:

> "...the total amount claimed under each contract is merely the sum of the values placed on all the individual elements which Newport News has identified as being the responsibility of the Government..."

Mr. Diesel stated:

> "We took each element that we felt was truly Government responsibility, and costed that out, and let it fall where it may."

Mr. Diesel also stated:

> "Claims are a legal procedure provided for in the basic contract, and I emphasize that. They are not, as some would have us believe, a bailout by which the Contractor can recover losses that he was responsible for."

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[redacted]

31. Claim Item 3.2.8, submitted by the company under the CVN 68-70 construction contract deals with nuclear discrepancy reports (DR's). Discrepancy reports are submitted to cognizant Contractor personnel by the Contractor's Quality Inspection Department (QID) when Government or Contractor furnished material is determined not to meet specification requirements. These reports provide the basis for taking necessary corrective action

32. In Claim Item 3.2.8 the Contractor states that CVN 68 Class construction contract inspection requirements are not unusual, but that excessive discrepancy reports were issued because:

> "The Government, ...has forced the Contractor's Quality Departments and particularly its Quality Inspection Department (reactor plant inspection) to greatly increase the scope of their activities. In relation to QID inspection, the number of deficiencies reported in reactor plant materials increased 216 percent.... This increase has manifested itself in both Contractor furnished and Government furnished reactor plant materials."

33. In support of this allegation, the Contractor stated that 12,646 DR's were issued against CVN 68 and that at the time of claim preparation the Contractor projected that about 10,000 DR's would be issued against CVN 69. The claim states that the number of actual and anticipated DR's is "excessive" based on the Contractor's prior experience that only 653 DR's were written on the average for five SSN 637 Class submarines constructed by Newport News in the period 1964 to 1969, prior to CVN 68 Class contract definitization. The claim states that a reasonable quantity of discrepancy reports to expect for each CVN 68 Class vessel is 5,224 DR's — representing the average of 653 DR's issued against the cited submarines multiplied by a factor of 8 to account for increased size and complexity of the carriers. Newport News claims that the Government should now pay the administrative costs associated with processing the actual CVN 68 DR's and those projected for CVN 69 which exceed the "reasonable" expectation of 5,224 DR's even though most of them report discrepancies resulting from poor workmanship by the Contractor.

34. On this basis, the Contractor concluded that 6,970 DR's issued against CVN 68, and 5,506 DR's issued or to be issued against CVN 69, are "excessive" DR's resulting from the Government's "forcing" Newport News to greatly increase its quality control activities. For each of these "excessive" DR's the Contractor requested compensation for four production hours, eight QID inspection hours, and ten engineering hours, yielding a total of 274,472 target manhours for this portion of the claim item.

[redacted]

[redacted]

35. The claim also stated that based on a "random" sample analysis of DR's issued against CVN 68, 1,698 DR's entailed productive effort to correct Government responsible deficiencies for which the Contractor has not been compensated. By applying percentages derived from this sample analysis to the 10,000 DR's projected by the Contractor on CVN 69, the Contractor concludes that he has not—or will not—obtain funding for an additional 1,341 Government responsible CVN 69 discrepancies. For each of the total 3,039 allegedly Government responsible unfunded DR's, the Contractor requests compensation for 36 engineering hours, 40 production hours, and QID effort, thus asking a total of 269,863 target manhours for this portion of the claim item.

36. For all effort claimed in Claim Item 3.2.8, the Contractor requests an adjustment in the contract target cost of $5,566,633 and $7,431,455 in the contract ceiling price.

37. NAVSEA 08 evaluation of Claim Item 3.2.8 has identified numerous inaccuracies, contradictions, misstatements of fact, improper or incomplete treatment of data, and omission of relevant information readily available to and known by the Contractor. For example:

- Contrary to the claim assertion that the CVN 68 Class construction contract inspection requirements were not unusual, it should be noted that this was the first nuclear construction contract at Newport News to invoke MIL-Q-9858A for reactor plant material inspection. MIL-Q-9858A expressly states that the requirements contained therein are in excess of those specified by MIL-I-45208 which was invoked by prior contracts at Newport News including those for construction of the SSN 637 Class submarines, cited as the basis for calculations in the claim.

- Contractual incorporation of MIL-Q-9858A reflected Newport News' continual upgrading of their nuclear quality control system throughout the 1960's. For example, in 1968, about two years before the CVN 68 Class construction contract was definitized, the Contractor issued revised internal procedures for implementation of quality control. By letter to NAVSHIPS dated April 24, 1969 the Contractor stated:

  > "The changes to our overall reactor plant quality control systems over the period of six years (1963-1968) are reflective of continuing efforts to adapt to contractual requirements and at the same time to provide adequate control on items which we at NNSD feel to be critical. A good quality control system must be adaptable to changing situations and as a result is constantly

[redacted]

[redacted]

[redacted]

under change...The overall QC system implemented by the new procedures is an improved system over the one previously employed...." (emphasis added) It should be noted that the claim neglects to mention this letter.

- Detailed analysis of individual DR's shows that the Contractor greatly overstated the potential productive effort associated with resolving DR's written—or expected to be written—on defective Government furnished equipment.

- The claim did not mention the Contractor's consistent failure to comply with contract requirements for requesting compensation for DR's if he considered additional compensation was justified. In fact, by claiming compensation for resolving DR's for CVN 69 which had not even been issued at the time of claim preparation, the Contractor ignored the fact that normal administrative procedures are available to—and in fact are being used by—the Contractor for obtaining such compensation. Thus, the Contractor's claim may in fact entail an attempt to get double recovery of compensation for some claimed DR's.

- Only about 7,000 DR's had been issued on CVN 69 as of ship delivery. Yet the Contractor based his claim on his projection that 10,000 DR's would be issued against CVN 69. Further, data was available to the Contractor which would have enabled him to project at the time of claim preparation that the quantity of CVN 69 DR's to be issued would be far less than 10,000.

- The sum of 5,224 DR's considered by the Contractor to be a "reasonable" expectation per carrier and the 5,506 CVN 69 DR's considered by him to be "excessive" is 10,730—730 more than the 10,000 DR's the Contractor projected for this hull.

- The DR's actually issued against the CVN 69 fall well within the range derived by multiplying by eight the range of DR's cited for the five SSN 637 Class submarines. The Contractor erroneously treated the average number of DR's for five SSNs as the basis for projecting the maximum number which could "reasonably" be expected.

- The Contractor's use of prior SSN 637 Class submarine data to obtain a reasonable quantity of

[redacted]

[redacted]

[redacted]

CVN 68 Class DR's expected on CVN 68 and CVN 69 is inaccurate, incomplete, and misleading. The Contractor did not mention in the claim that the submarines cited were the 16th through 20th S5W type reactor plants built by the Contractor; whereas, the A4W type reactor plant in the CVN 68 was of an entirely new design. Also, the Contractor merely cited the total number of DR's issued against the five SSN 637 Class submarines, without mentioning that his own records break down these totals by designating whether the DR's were issued against Government furnished or Contractor furnished material. By further evaluating this data, the NAVSEA 08 analysis demonstrates that for the CVN 68, disproportionate numbers of DR's were issued for Contractor responsible—not Government responsible—material. This finding contradicts the Contractor's allegation that the increases in numbers of DR's issued for both Contractor and Government furnished material were equivalent.

38. The Contractor's claim does not even mention manpower problems as a factor influencing discrepancies, even though the number of DR's is a direct function of workmanship and productivity problems. A NAVSEA 08 time phasing analysis of CVN 68 and CVN 69 DR's issued over the respective ship construction cycles showed that disproportionate numbers of CVN 68 DR's were issued over the period 1971-1974. This cannot be explained solely by normal construction events but coincides with the period of maximum manpower problems. To supplement this finding, NAVSEA 08 reviewed the 18 audit reports in Government files issued by the Newport News' Quality Inspection Department which reviewed the Contractor's own production departments over the period 1971-1974. As noted in paragraph 10 above, these Contractor audits repeatedly identified Contractor workmanship and human error as sources of the discrepancies reported and recommended corrective measures such as increased supervision, training programs, and so forth. The audit reports include summaries of the sources of the discrepancies reviewed and clearly illustrate that the preponderance of discrepant work resulted from Contractor responsible actions.

39. Additional evidence relating discrepancies on nuclear work to Contractor manpower problems is discussed in paragraphs 5 through 18 above. Presumably, this and other pertinent information are contained in the Contractor's files and were available at the time of claim preparation—yet Claim Item 3.2.8 makes no mention of the existence of such information.

40. Another indication of the inflated nature of the Contractor's claim is illustrated by the following. In April, 1971 the Contractor budgeted 744,600 Quality Inspection Department manhours for the CVN 69 to perform the work included in the

contract as originally definitized. Actual QID manhours expended as of 30 September 1977 was 658,900, 85,700 fewer manhours than budgeted in April, 1971 for the original contract work. Yet, apparently without even taking into account the manpower problems discussed above, Claim Item 3.2.8 alleges that the Government should pay for over 60,000 additional QID manhours for the CVN 69. The total CVN 69 claim alleges that the Government owes Newport News for more than 130,000 QID manhours.

41. There are many other items in the Newport News claims which include features similar to those of Claim Item 3.2.8— the questionable use of "random" sample analysis, the omission of material facts, the faulty and misleading reliance on prior ship construction experience, and so forth. Taken together, these items appear to have been carefully coordinated, possibly with the advice of legal counsel, thus raising the question of whether techniques were developed and provided to Newport News claims team members for the purpose of portraying Government responsibility for Contractor responsible items in such a way that fraudulent or false intent would be difficult to prove. This raises the further question whether such coordination of the claims, if it were found to exist, would not itself violate applicable statutes. Of course, whether or not the Newport News claims violate fraud or false claims statutes cannot be determined until they are fully investigated. It is for that reason that I urge the Navy to request the Justice Department to assign the resources necessary to investigate the claims properly.

42. Reference (h) defines fraud as any wilful means of taking or attempting to take unfair advantage of the Government including, but not limited to, deceit either by suppression of the truth or misrepresentation of a material fact. Reference (h) requires any person in the Naval establishment who has knowledge of possible fraud to report such knowledge to appropriate authorities.

H. G. Rickover
H. G. Rickover

Copy to: (With enclosure)

Inspector General, Naval Sea Systems Command (NAVSEA 00N)
Chairman, Navy Claims Settlement Board (NAVMAT 00X)

EXHIBIT G

FEBRUARY 8, 1978 -- MEMO FROM MARK M. RICHARD TO JOHN C. KEENEY RE: SHIPBUILDING REFERRALS FROM THE DEPARTMENT OF THE NAVY

OPTIONAL FORM NO. 10
JULY 1973 EDITION
GSA FPMR (41 CFR) 101-11.6
UNITED STATES GOVERNMENT

Memorandum

TO : John C. Keeney
Deputy Assistant Attorney General
Criminal Division

DATE: February 8, 1978

FROM : Mark M. Richard
Chief, Fraud Section
Criminal Division

MMR:ca

SUBJECT: Shipbuilding Referrals from the Department of the Navy

On this day I received a telephone call from Togo West, General Counsel of the Navy, informing me that they will be referring to us in the next several days three (3) Shipbuilding claim matters which may involve fraud. Two of these matters, the Newport News and the Electric Boat Corporation, have received considerable Congressional notoriety over the past several months. Admiral Rickover has publicly asserted that both cases involve claims permeated with fraud. Senator Proxmire has held numerous hearings on these matters and has been pressuring the Navy to examine closely these allegations.

Mr. West indicated that later this day there will be a meeting with the President and presumably he will have occasion to advise the President of these contemplated referrals.

In light of our prior experience with such referrals and the difficulty we have traditionally encountered in developing prosecutable cases in this area, it is suggested that consideration be given to establishing a specialized group of attorneys and investigative personnel within the Division to focus on these cases. This group presumably would include Department of Defense auditors and, if needed, even General Counsel attorneys who would be specially appointed to work under our supervision. With respect to the auditing component, it is hoped that we will not encounter any problems under the Posse Commitatus Act.

Agreed
yes
yes
NONE.

2/18
JK
21

5010-110

Buy U.S. Savings Bonds Regularly on the Payroll Savings Plan

E-1

EXHIBIT H

FEBRUARY 15, 1978 -- MEMO FROM MIKE KELLY TO BENJAMIN CIVILETTI
RE: JUDGE BELL'S COMMENTS TO MEMO

COUNSELOR TO THE
ATTORNEY GENERAL

February 15, 1978

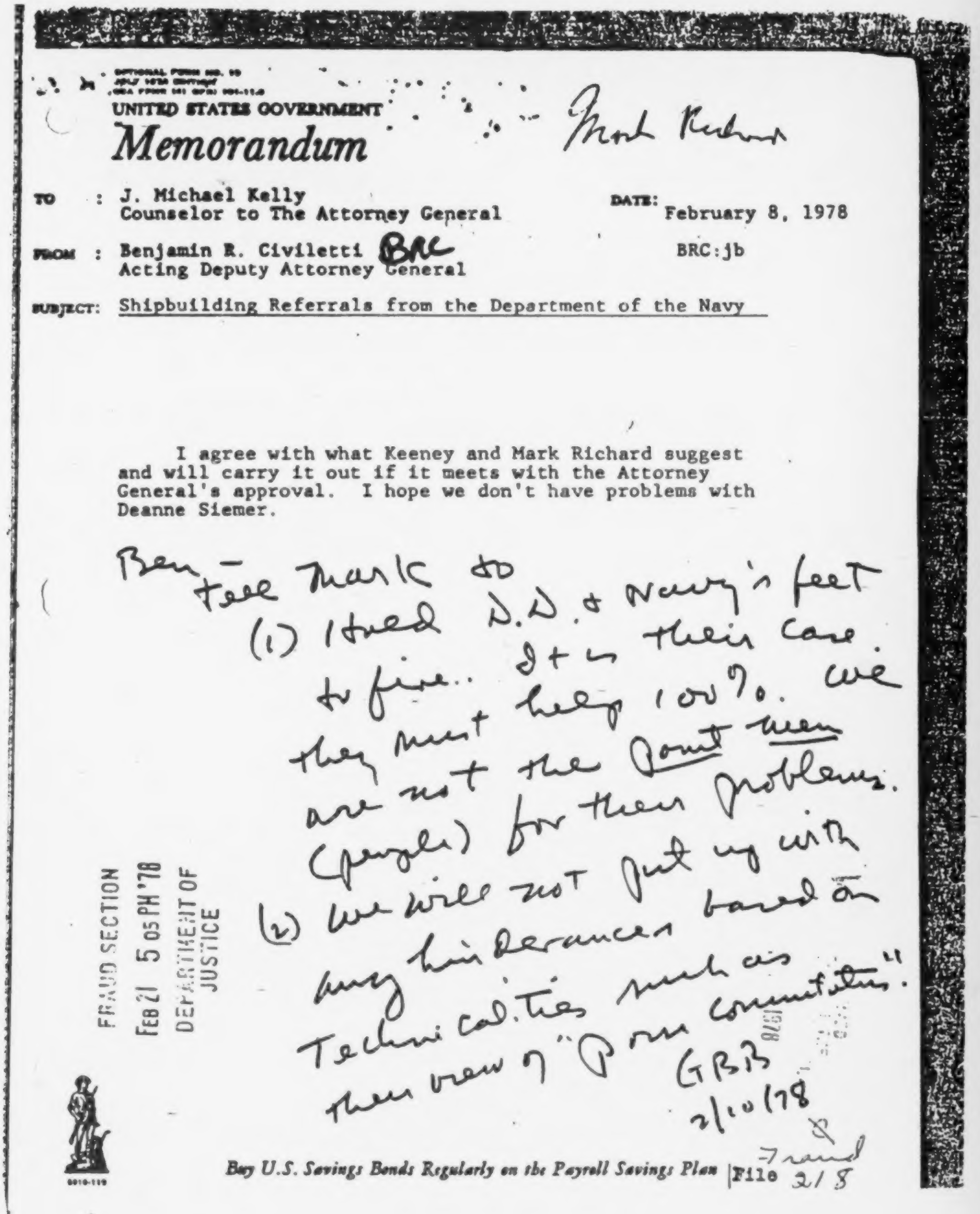
TO: Benjamin Civiletti
Acting Deputy Attorney
General

FROM: Mike Kelly

2/16/78

Please note Judge Bell's comments.

To Jack & Mark
See my notes & J Bells.
Prepare good reply letter to
Togo West laying out import.
of close work, manpower &
gearing up & whatever
else is appropriate in
response to his concerns
BRC
2-15-78



OPTIONAL FORM NO. 10
JULY 1973 EDITION
GSA FPMR (41 CFR) 101-11.6

UNITED STATES GOVERNMENT

Memorandum

Mark Richard

TO : J. Michael Kelly
Counselor to The Attorney General

DATE: February 8, 1978

FROM : Benjamin R. Civiletti BRC
Acting Deputy Attorney General

BRC:jb

SUBJECT: Shipbuilding Referrals from the Department of the Navy

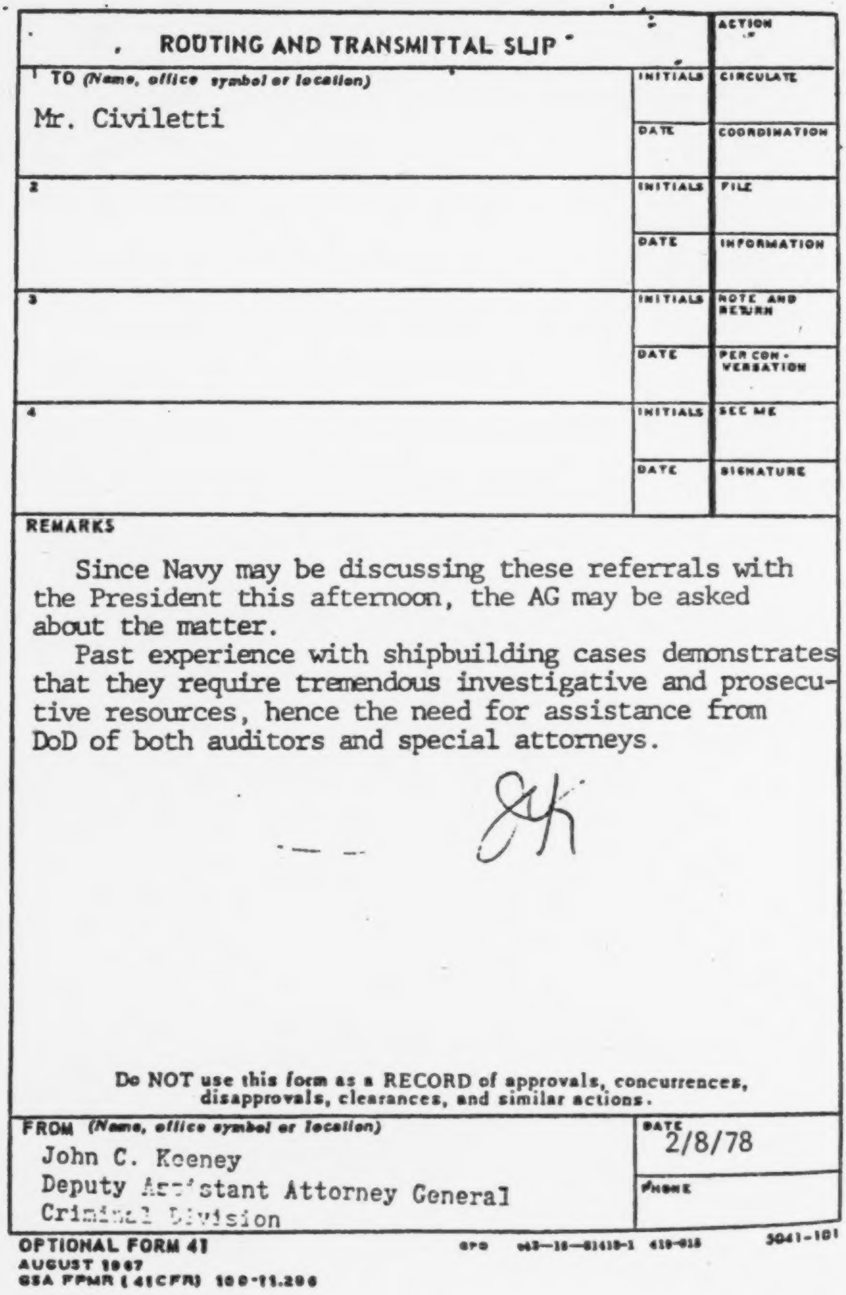
I agree with what Keeney and Mark Richard suggest and will carry it out if it meets with the Attorney General's approval. I hope we don't have problems with Deanne Siemer.

Ben —
Tell Mark to
(1) Hold D.D. & Navy's feet to fire.. It is their case. they must help 100%. We are not the point men (people) for their problems.
(2) We will not put up with any hinderances based on Technicalities such as their view of "prior commitments".
GBB
2/10/78

FRAUD SECTION
FEB 21 5 05 PM '78
DEPARTMENT OF JUSTICE

Buy U.S. Savings Bonds Regularly on the Payroll Savings Plan

File Fraud 2/8



ROUTING AND TRANSMITTAL SLIP

1 TO *(Name, office symbol or location)* Mr. Civiletti	INITIALS	ACTION
	DATE	CIRCULATE
		COORDINATION
2	INITIALS	FILE
	DATE	INFORMATION
3	INITIALS	NOTE AND RETURN
	DATE	PER CONVERSATION
4	INITIALS	SEE ME
	DATE	SIGNATURE

REMARKS

Since Navy may be discussing these referrals with the President this afternoon, the AG may be asked about the matter.

Past experience with shipbuilding cases demonstrates that they require tremendous investigative and prosecutive resources, hence the need for assistance from DoD of both auditors and special attorneys.

Do NOT use this form as a RECORD of approvals, concurrences, disapprovals, clearances, and similar actions.

FROM *(Name, office symbol or location)*
John C. Keeney
Deputy Assistant Attorney General
Criminal Division

DATE 2/8/78

PHONE

OPTIONAL FORM 41
AUGUST 1967
GSA FPMR (41CFR) 100-11.206

GPO 063-16-81410-1 410-018

5041-101

EXHIBIT I

APRIL 12, 1978 -- LETTER FROM JOHN C. KEENEY TO DEANNE SIEMER, RE: NAVY REFERRALS

T: 4/12/78
BRC:RMR:JJG:jar
46-31-99
46-18-298

April 18 1978

Ms. Deanne C. Siemer
Office of General Counsel
U.S. Department of Defense
Washington, D.C. 20301

Dear Ms. Siemer:

We have recently received three referrals from the Department of the Navy alleging substantial fraud in shipbuilding claims submitted by Bath Iron Works, Inc., Newport News Shipbuilding Co., and Electric Boat Division of General Dynamics Corporation.

Based on our previous investigative and prosecutive experience in shipbuilding fraud cases, we have decided to pursue these investigations differently. Instead of limiting the investigation team to the FBI, and a prosecutor, we have been discussing with Mr. Togo D. West, Jr., the possibility of securing the full-time assistance of a Navy attorney familiar with the claims processes to act as a co-counsel with our prosecutor. We would also require a Naval Investigative Service civilian investigator, and a Department of Defense auditor. A team so constructed would additionally include at least one FBI special agent accountant. A separate team so organized would be formed to act on each referral.

The intent is to combine multiple talents on one investigative team to conduct a more rapid and efficient investigation and, if warranted, prosecution than has been possible previously. Mr. West has indicated his approval of the approach and requested we seek your concurrence through this letter. To date, Mr. West has identified two attorneys from his

4-12-78

Records
Section Chron
Mr. Graham
Mr. Civiletti
Ruth Boyd
HOLD

E-6

- 2 -

office for this assignment, Saundra Adkins and Eugene Paulish.

We believe this approach is consistent with Deputy Secretary Duncan's letter of December 21, 1977, which offered the services of twenty-five attorneys for temporary assignment to our Department. Since the referrals are now pending, we would seek your attention as quickly as possible so the investigation can be initiated.

Very truly yours,

Benjamin R. Civiletti
Assistant Attorney General
Criminal Division

By:
John C. Keeney
Deputy Assistant Attorney General
Criminal Division

EXHIBIT J

JUNE 2, 1978 -- LETTER FROM NAVSEA 08 (RICKOVER) TO THE SECRETARY OF THE NAVY

DEPARTMENT OF THE NAVY
NAVAL SEA SYSTEMS COMMAND
WASHINGTON, D.C. 20362

[redacted]

[redacted]

IN REPLY REFER TO
2 June 1978

[redacted]

From: Deputy Commander, Nuclear Propulsion Directorate (NAVSEA 08)
To: Secretary of the Navy

Subj: Additional instances of possible fraud in Newport News claim under CVN 68 Class construction contract N00024-67-C-0325

Ref: (a) My ltr of 19 May 1977 to NAVMAT 00X and NAVSEA 00N
(b) My ltr of 14 Jul 1977 to NAVMAT 00X and NAVSEA 00N
(c) My ltr of 1 Nov 1977 to NAVMAT 00X and NAVSEA 00N
(d) My ltr of 18 Nov 1977 to NAVMAT 00X and NAVSEA 00N
(e) My ltr of 30 Dec 1977 to you
(f) My ltr of 3 Jan 1978 to you
(g) My ltr of 5 Jan 1978 to you

Encl: (1) Preliminary Claim Item Technical Analysis Report 3.2.1, "Ship Arrangement Problems"

1. In references (a) through (g), I reported items in the Newport News claims which I believe should be investigated for possible violation of statutes relating to fraud and false claims. I understand that the Navy has referred my reports to the Justice Department for investigation. The purpose of this letter is to report additional items in the NIMITZ claim which I believe should be referred to the Department of Justice.

2. Reference (g) explains the background of the Newport News claims. The key events are summarized below:

- Severe shipyard manpower problems in the early 1970's greatly increased costs.
- In 1973 and 1974 Tenneco and Newport News officials attempted, unsuccessfully, to get their fixed price contracts changed to cost type contracts.
- As early as 1974 a large team was assembled by Newport News to prepare claims.
- In 1975 and 1976 claims for almost $900 million in ceiling price increases were submitted, of which $742 million are still unresolved.

[redacted]

[redacted]

- The largest claim, still unresolved, is $221 million for the NIMITZ and the DWIGHT D. EISENHOWER. Without any recovery on this claim, Newport News expects to recover all costs plus a profit of about $26 million.

- Newport News threatened to stop Navy work. The company, led by Mr. J.P. Diesel, Chairman of the Board of Newport News, embarked on a publicity campaign to pressure the Navy to pay off the claims quickly.

3. As noted in reference (g), Mr. Diesel testified on March 23, 1977 to the Defense Subcommittee of the House Appropriations Committee that:

> "...the total amount claimed under each contract is merely the sum of the values placed on all the individual elements which Newport News has identified as being the responsibility of the Government...".
>
> "We took each element that we felt was truly Government responsibility, and costed that out, and let it fall where it may."

4. Review of the NIMITZ and EISENHOWER claim, however, indicates that the company did not simply cost out each claim element and "let it fall where it may." In fact it appears that the claim was deliberately crafted to conceal the fact that it includes tens of millions of dollars for items for which Newport News has already been paid; costs that were never incurred; for multiple claims for the same costs; or for costs that are the contractual responsibility of Newport News. In total, the Newport News claims are so inflated that the company can accept settlements at a small fraction of the face amounts of the claims and still recover all actual costs plus the desired profit.

5. In this respect, the 1977 Tenneco Annual Report to stockholders is deceptive. It implies that Newport News will be required to absorb the difference between the $742 million in outstanding Newport News claims and $186 million booked by the company as expected revenue from these claims. Actually these claims are so inflated that if Newport News were paid $186 million, they would recover all costs and about a five percent profit. Also, by booking $186 million income from these claims, Newport News has been able to report record profits for the past two years, while simultaneously writing off at least $85 million in losses on commercial shipbuilding.

[redacted]

[redacted]

6. Navy analysis shows that Newport News is contractually entitled to far less than the booked-income of $186 million. Company officials do not want to settle claims for amounts that would require a reduction in profit projections previously reported to stockholders. This is the principal reason that the Newport News claims have not been settled.

7. Enclosure (1) is the NAVSEA 08 analysis of Claim Item 3.2.1, "Ship Arrangement Problems," submitted by Newport News under the contract to construct three NIMITZ Class aircraft carriers. This item requests an increase in ceiling price for the NIMITZ of about $400,000. Although not large in the context of the total claim, this item contains many misrepresentations of fact, including Newport News attempts to:

- blame the Government for the company's own design and construction mistakes;
- make the Government pay for design improvements which the company elected to make without even informing the Government;
- ignore contract specifications and provisions which clearly show that work now claimed is within the scope of the CVN 68-70 construction contract;
- portray Newport News employees as Government agents and claim that these employees directed the company to perform added work when this was not the case.

As discussed in detail in enclosure (1), there is written evidence to indicate that the Executive Vice President of Newport News, as well as the head of the company's claim preparation effort, were informed by a senior company official expert in the areas claimed that the underlying rationale of Item 3.2.1 is factually wrong. Seven weeks after these officials were informed, Newport News revised and resubmitted the claim item: this expert's findings were apparently disregarded; the rationale for Government responsibility remained unchanged; but the amount claimed was increased by about $200,000.

8. There is another problem with the NIMITZ claim. On the surface the amounts claimed for individual items often appear to be plausible. But by scrutinizing the various parts of the claim and comparing them, one discovers that during some periods of ship construction Newport News claims to have expended more manhours on that portion of the work cited in the claim than the total effort actually expended for all work during these periods; that is, the sum of the parts is greater than the whole. Here is an example:

[redacted]

[redacted]

- Of the $221 million increase in ceiling price claimed on the carrier contract, $100 million is for the NIMITZ. Of this amount, $69.8 million is for 6.9 million non-engineering labor manhours and associated material.

- Of these 6.9 million manhours, 2.6 million cover 43 specific claim items.

- Detailed analysis shows that over 1.84 million of the 2.6 million manhours are alleged to have been expended during the period between the original contract delivery date of 30 September 1973 and the actual delivery date of 11 April 1975.

- In alleging the Government to be responsible for these 1.84 million non-engineering manhours, Newport News also acknowledges that it is responsible for work associated with the 43 items. This contractor responsible work, according to the claim, amounts to 3.44 million non-engineering manhours expended during this same period.

- Adding the 3.44 million non-engineering manhours acknowledged to be Newport News responsibility to the 1.84 manhours claimed to be a Government responsibility gives a total of 5.28 million non-engineering manhours allegedly incurred during this period for work in areas covered *only* by the 43 claim items.

- Newport News cost records show that Newport News actually spent only 4.7 million *total* non-engineering manhours on the NIMITZ during this period. This total covers not only the 43 identified claim items but all other work on the ship as well; e.g., fueling and testing of the reactor plant, completion and testing of other major portions of the ship, and incorporation of over a million manhours of changes.

- Thus, the claim represents that Newport News expended 580,000 more non-engineering manhours *solely* on the 43 items than the *total* expended on the *whole* ship during this period.

[redacted]

[redacted]

9. Newport News also inflated its claim by alleging that the Government is responsible for having disrupted a portion of every hour expended. In so doing, Newport News assessed disruption against manhours for which it had already claimed the Government is fully responsible. For example, disruption is assigned by the company to the 1.84 million non-engineering hours already claimed to be fully Government responsible for work performed after September 1973. This results in a double claim of 279,000 manhours. Against 650,000 non-engineering hours of allegedly Government responsible work performed prior to September 1973, there is a double claim of 57,000 hours.

10. Newport News further exaggerated the claim by alleging that the Government is responsible for "deterioration" of labor due to workers stretching out the work in accordance with "Parkinson's Law". To calculate the amount, the company assigns a rate of "deterioration" to all manhours, including the 1.84 million hours previously discussed. Since disruption was also claimed against these hours, the 146,000 non-engineering hours claimed for "deterioration" on the 1.84 million manhours constitutes a triple claim.

11. Newport News also significantly overstates the engineering applied to the 43 claim items in the 18½ month period starting in September, 1973. Here are the facts:

- The claim alleges that the Government owes Newport News for the inflationary cost of deferring one million manhours of basic unchanged contract engineering work to the period from 24 August 1973 to ship delivery.

- Although not mentioned in the claim, the company's own contract change reports show that Newport News was authorized at least 364,000 hours of engineering for changed work on the NIMITZ during this period.

- In the claim, Newport News alleges that the Government owes the company for an additional 182,000 engineering hours expended during the same period in resolving the 43 claim items.

- One million hours of unchanged basic contract work, plus 364,000 hours of changed work, plus 182,000 hours of claimed work during this period would have required Newport News to expend 1,546,000 engineering manhours.

- The actual engineering manhours expended by Newport News from 24 August 1973 to ship delivery, according to the claim, was only 1,238,709--about 300,000 hours less than the total discussed above.

[redacted]

[redacted]

c Further, against the 182,000 engineering hours claimed for work during this period, the claim includes a double claim of 22,000 engineering hours for disruption.

12. It is also interesting to note that the NIMITZ claim includes a disruption charge for over 130,000 hours for engineering work performed before January 1970. The claim does not mention that the Newport News bid proposal for the definitization of the contract was updated by Newport News in February 1970 based on actual engineering costs through 5 January 1970. Thus, to the degree that disruption might have occurred in that work, it was covered by the definitized contract which was signed in September 1970. Therefore, the 130,000 hours claimed represents a claim for work already required by contract.

13. While it is inevitable that there could be mistakes in the Newport News claims, it appears that the NIMITZ claim was deliberately constructed to mislead the Government. Detailed examination of the claim reveals many examples where the contractor had data readily available in his records--but not revealed in the claim--which would show that the claimed amounts are not valid.

14. There is evidence that the situation I have described is not unique to the NIMITZ claim. Nor do I believe it is confined to the nuclear aspects of the Newport News claims. Therefore, I recommend that the Navy review the other Newport News claims to determine the full extent to which the company has accounted for more manhours in its claims than actually spent.

15. I also recommend that this letter and its enclosure be promptly forwarded to the Justice Department in connection with their ongoing investigation of the Newport News shipbuilding claims.

H. G. Rickover
H. G. Rickover

Copy to: (with enclosure)
Inspector General, Naval Sea Systems Command (NAVSEA 00N)
Chairman, Navy Claims Settlement Board (NAVMAT 00X)

[redacted]

EXHIBIT K

JULY 19, 1978 -- LETTER FROM NAVSEA 08 (RICKOVER) TO THE SECRETARY OF THE NAVY

DEPARTMENT OF THE NAVY
NAVAL SEA SYSTEMS COMMAND
WASHINGTON, D.C. 20362

IN REPLY REFER TO

19 July 1978

[redacted]

From: Deputy Commander, Nuclear Propulsion Directorate (NAVSEA 08)
To: Secretary of the Navy

Subj: Additional instances of possible fraud in Newport News claim under CVN 68 Class construction contract N00024-67-C-0325

Ref:
(a) My ltr of 19 May 1977 to NAVMAT OOX and NAVSEA OON
(b) My ltr of 14 July 1977 to NATMAT OOX and NAVSEA OON
(c) My ltr of 1 Nov 1977 to NATMAT OOX and NAVSEA OON
(d) My ltr of 18 Nov 1977 to NAVMAT OOX and NAVSEA OON
(e) My ltr of 30 Dec 1977 to you
(f) My ltr of 3 Jan 1978 to you
(g) My ltr of 5 Jan 1978 to you
(h) My ltr of 2 June 1978 to you
(i) Newport News ltr 595/C1-1-1 of 11 July 1978 from C. L. Willis, Director of Contract Controls, to RADM F. F. Manganaro, Chairman, Navy Claims Settlement Board

1. In references (a) through (h), I reported items in the Newport News claims which I believe should be investigated for possible violation of statutes relating to fraud and false claims. I understand that the Navy has referred my reports to the Justice Department for investigation. The purpose of this letter is to report additional items relating to the claim on the CVN 68 Class construction contract which I believe should be referred to the Department of Justice.

2. On July 12, 1978 Newport News delivered reference (i) to the Navy Claims Settlement Board. Reference (i) furnished additional information and documentation in support of the Newport News claim on the CVN 68 Class construction contract. I understand that reference (i) was prepared by Newport News in an attempt to pursuade the Navy Claims Settlement Board to increase its valuation of the Newport News claims. Newport News no doubt wants the Board to furnish Assistant Secretary Hidalgo a higher value for the claims for use in his on-going claims settlement negotiations with Mr. J. P. Diesel, Chairman of the Board, Newport News. The Chairman of the Navy Claims Settlement Board

[redacted]

[redacted]

referred reference (i) to my office for comment, since much of the information enclosed therein relates to matters under my cognizance.

3. My staff's review of reference (i) and its enclosures has not revealed any increased entitlement for items under my cognizance over that previously reported to the Claims Board in Claim Item Technical Advisory Reports. However, reference (i) enclosed several documents prepared by Newport News, some eight years old, which confirm many of the statements I made in references (a) through (h) concerning statements in the Newport News claims which appear to be a "willful means of taking or attempting to take unfair advantage of the Government including, but not limited to, deceit either by suppression of the truth or misrepresentation of a material fact." Also, reference (i) submitted a new allegation by Newport News concerning Government responsibility for delay in the construction of the DWIGHT D. EISENHOWER (CVN 69). This new allegation also appears to be false, as explained below.

4. In references (e) and (h), I recommended that Claim Item 4.1.2, "Government-Responsible Delay—USS DWIGHT D. EISENHOWER (CVN 69)," submitted by Newport News under the contract to construct three NIMITZ Class carriers (CVN 68-70), be investigated for possible violation of fraud or false claim statutes. Reference (i) enclosed documents which directly confirm the concerns I expressed about this claim item. In addition, reference (i) sets forth a new allegation that the EISENHOWER was delayed due to Navy changes to innerbottom shielding. Reference (i) states:

> "Construction on Shipway #9 was delayed due to Navy changes which held up work on innerbottom shielding. Sufficient manpower was available at the time of the holdups; however, the work was subsequently released during a peak manpower period when other scheduled work was requiring available manpower."

5. In support of the allegation that Navy changes to innerbottom shielding delayed the EISENHOWER, reference (i) enclosed a memorandum of a telephone conversation of 5 December 1977, between Mr. R. D. Bradway, and Messrs. T. C. Chandler and D. D. Eason concerning Mr. Bradway's recollection of events which took place over six years earlier, between January 1971 and September 1972. Mr. Bradway is currently in the Newport News Contract Administration Department, but in 1971 he was General Superintendent, Steel Hull Division and in charge of hull construction for aircraft carriers. Messrs. Chandler and Eason are currently in the Contract Controls Department. In the 1971-1972 period Mr. Eason was Manager of Production Control; in that capacity he was intimately involved in monitoring the construction progress of all production work in the yard.

[redacted]

[redacted]

6. Messrs. Chandler and Eason report that on 5 December 1977 Mr. Bradway recalled that:

"Structural work for Hull 599 (CVN 69) was proceeding normally to meet a May 1972 transfer into Number 11 Dry Dock until January 1971 when holdups based on Navy changes were received on the innerbottom shielding under reactor compartments Number 1 and Number 2. As efforts to readily resolve the holdups were unsuccessful, in March 1971, the innerbottom assemblies were removed from the shop and put into storage. Structural erection on shipway number nine subsequently slowed and virtually came to a stop later in the summer when the late innerbottoms held up adjoining work and prevented erection of the non-nuclear structure. During the early part of 1971, sufficient manpower was available to erect the structure if work could have proceeded. However, when the holdups on the shielded innerbottoms were released in September 1971, shop space and manpower had been allocated to other Navy work and was not available as planned. As a result we had to build temporary structures over the innerbottoms and complete them on the platens instead of in the shop."

"When the holdups were released in September 1971, we had about seven months remaining before the scheduled May 1972 transfer. If manpower had been available in the skilled trades at that time, we could have completed the section of hull required for transfer in May 1972. However, by September, other scheduled work was requiring use of available resources, manpower and facilities. As a result of the holdup to scheduled shielding work and its subsequent release during a peak manpower period, construction of Hull 599 (CVN 69) was slowed and the hull was not ready to transfer into Number 11 Building Dock until September 1972."

"In summary, if work could have proceeded without the six-month holdup in shielding, the May 1972 transfer date would have been met. Additionally, if manpower had been available after the shielding holdups were released, the May 1972 transfer could still have been met. The lack of manpower available to Hull 599 (CVN 69) after the release of shielding holdups in September 1971 caused the May 1972 transfer of Hull 599 (CVN 69) to be rescheduled to September 1972." (Emphasis added)

7. In addition, based on the above report of Mr. Bradway's recollections, reference (i) states:

"There is a question as to whether the Company made optimum use of its resources while the CVAN68 (sic;should be CVAN69) machinery box was on the building way. Enclosed

[redacted]

[redacted]

> is documentation which we believe clearly demonstrates this fact. In brief, the enclosed documentation reveals, during the preparatory and early construction phases, optimum resources were applied to the task. The enclosed documentation also confirms that during the latter stages of construction, manpower became a constraint. This conforms to the rationale contained in the REA that effort had to be continued on CVAN 68 for a much longer period than anticipated and that the inability to assign manpower to CVN 69 was the direct result. Since delay to CVAN 68 was Navy responsible, problems with balancing the manpower resource are to a large extent Navy responsible." (Emphasis added)

8. Had Newport News reviewed reports Mr. Eason and Mr. Bradway issued in 1971 and 1972 it would have been obvious that the events at that time did not take place in the manner represented in reference (i). Further, had Mr. Willis, the head of the Contract Controls Department and signer of reference (i); or his subordinates, Mr. Chandler and Mr. Eason; or Mr. Bradway in his present capacity in the Contract Administration Department; checked the carrier contract they would have discovered that in December 1973 Mr. C. E. Dart, Vice President, signed a fully adjudicated contract modification covering the effects of the shielding change to both the NIMITZ and the EISENHOWER. It should be noted that Mr. Dart signed this modification more than 18 months after the innerbottom shielding work was completed and over a year after the EISENHOWER was transferred to the Shipway #11 Dry Dock. In this contract modification it was mutually agreed that "the prescribed changes resulted in no change in delivery schedule for the applicable ships." This contract modification concluded with the following release:

> "5. The change in delivery dates, target cost, target profit and ceiling price, described above is considered to be fair and reasonable and has been mutually agreed upon in full and final settlement of all claims arising out of this modification and any other modifications or change orders indicated above including all claims for delays and disruptions resulting from, caused by, or incident to such modifications or change orders."

9. Review of Navy files of reports prepared by Newport News shows that:

- On 23 December 1970, almost a month before the innerbottom shielding holdup, Mr. Bradway issued a revised work schedule for 1971 which projected more than a four month slippage in the EISENHOWER erection schedule by the end of 1971.

[redacted]

- As of January 1971 erection of the EISENHOWER hull section on Shipway #9 was on or ahead of the June 1970 Newport News schedule. However, more than six months before January 1971 the manpower assigned to the shop work needed to support continued erection of the EISENHOWER hull began to fall short of the planned manpower allocation.

- The manpower shortfall on the EISENHOWER continued to grow until long after the launch of the hull section from Shipway #9. This shortfall was not caused by Government responsible delays on the NIMITZ, as alleged in the claim and reiterated in reference (i).

- On 18 January 1971, shield installation in one innerbottom subassembly for each reactor compartment was held up pending a change to the shielding installation.

- Construction photographs, work orders signed by Mr. Bradway, and production meeting minutes signed by Mr. Eason, show that work adjacent to the shielded innerbottom subassemblies proceeded, leaving space for later installation of the shielded subassemblies. No holdups to other subassemblies resulted from the shielding holdup.

- By Contract Modification A422, signed by Mr. L. C. Ackerman, President, on 9 July 1971, Newport News agreed to a maximum price for the effects of the shielding modifications and "agreed that this modification will result in no adjustment in the delivery schedule for the CVAN 68 and CVAN 69."

- Installation of shielding in the innerbottom subassemblies commenced in early August 1971.

- Newport News Operations Information Reports show that "due to lack of available manpower and the priorities established on other contracts" the total manning assigned to the EISENHOWER during 1971 was less than 60 percent of that planned. The "other contracts" identified in the reports include four Navy ships and two commercial contracts to jumboize tankers.

- By mid-September 1971 structural erection on Shipway #9 was about five months behind the revised hull erection schedule issued by Mr. Bradway in December 1970.

- The EISENHOWER structural erection log and construction photographs show that for the six months from mid-September 1971 until mid-March 1972 almost no

[redacted]

erection work took place on the building way. Total manning assigned to the EISENHOWER during this period averaged about 36 percent of planned manning. Most of the available manpower was needed for shop work; thus erection work on the building way essentially stopped. During this period Newport News reduced the planned size of the hull section to be built on Shipway #9 from 600 feet of length to 400 feet and reduced the height to be built by one deck level. Because of the shortage of manpower, even the smaller hull section could not be readied for launch by the planned date in May 1972, and it was rescheduled for August 1972.

- The erection log shows that the two shielded innerbottom subassemblies were landed on the ways for final erection on 27 March and 26 April 1972. These subassemblies were fully welded in by mid-June 1972 and were not in any way controlling the launch of the hull section, which was delayed until 9 September 1972 due to the slow rate of erection of other assemblies.
- By Contract Modification AD26 signed by Mr. C. E. Dart, Vice President, on 27 December 1973, Newport News agreed to full and final settlement for the effects of the shielding modifications including agreement "that the prescribed changes resulted in no change in delivery schedule for the applicable ships."

10. The introduction by Newport News in July 1978, in the midst of Mr. Diesel's settlement negotiations with Secretary Hidalgo, of a new—and incorrect—basis for claiming Government responsibility for delay of the EISENHOWER raises many serious questions.

- Did Newport News check their records before making the representations contained in reference (i)? If not, why not?
- How does the Company reconcile the great disparity between what they represent as Mr. Bradway's recollections of six year old events and the documents Mr. Bradway, Mr. Eason, and others signed at the time the events occurred?
- Were Mr. Bradway's 5 December 1977 recollections accurately recorded by Mr. Eason and Mr. Chandler?
- Why did Newport News generate and submit a second-hand account of Mr. Bradway's recollections?

[redacted]

[redacted]

- Why did Newport News represent that the shielding modification substantiates the EISENHOWER delay claim when the Company had contractually agreed to full and final settlement for the effects of this change in 1973 and that no change in ship delivery was involved?

- If Newport News considered the December 1977 record of Mr. Bradway's recollections to be valid why did the Company wait until July 1978 to submit this new basis for its claim that the Government is responsible for the EISENHOWER delay?

11. Reference (i) is yet another illustration that the claims submitted by Newport News:

- Contain statements which are demonstrably untrue.

- Contain statements apparently designed to mislead.

- Do not disclose documents which would disprove allegations of Government responsibility.

- Allege Government responsibility for costs which are the shipbuilder's contractual responsibility.

- Contain claims for costs that have already been reimbursed.

12. I recommend that this letter and reference (i) with its enclosures and references be promptly forwarded to the Justice Department in connection with their on-going investigation of the Newport News shipbuilding claims.

13. Reference (i) is typical of the problems we have frequently encountered in evaluating shipbuilding claims. To discourage false claims, the Navy Procurement Directives require senior contractor officials to certify at the time of claim submission that their claims and supporting data are current, complete and accurate. However, the Navy has not enforced this requirement with Newport News. I therefore recommend that as part of the on-going claims settlement negotiations with Newport News, you obtain the company's commitment to comply fully with the Navy Procurement Directives regarding identification, documentation, and certification of claims.

H. G. Rickover

Copy to:
Inspector General, Naval Sea Systems Command (NAVSEA OON)
Chairman, Navy Claims Settlement Board (NAVMAT OOX)

[redacted]

EXHIBIT L

1979 -- RESPONSE OF THE U.S. GOVERNMENT TO NEWPORT NEWS MOTION TO TERMINATE GRAND JURY PROCEEDINGS

IN THE UNITED STATES DISTRICT COURT FOR THE

EASTERN DISTRICT OF VIRGINIA

RICHMOND DIVISION

IN RE:)
)
GRAND JURY INVESTIGATION) CRIMINAL NO. 78-00083A-R
NEWPORT NEWS SHIPBUILDING)
AND DRYDOCK COMPANY)

RESPONSE OF THE UNITED STATES OF AMERICA TO MOTION OF NEWPORT NEWS FOR DISQUALIFICATION OF SPECIAL DEPARTMENT OF JUSTICE ATTORNEYS ADKINS AND PAULISCH AND FOR TERMINATION OF THE GRAND JURY PROCEEDINGS

WILLIAM B. CUMMINGS
UNITED STATES ATTORNEY

Eliot Norman
Eliot Norman
Assistant United States Attorney

Saundra J. Adkins
Special Department of Justice Attorney

Eugene B. Paulisch
Special Department of Justice Attorney

TABLE OF CONTENTS

Page

I. INTRODUCTION.. 1

II. QUESTION PRESENTED.. 2

III. COUNTER-STATEMENT OF FACTS.. 3

IV. ARGUMENT.. 16

- A. INTRODUCTION.. 16
- B. THE FACTS IN THE NEWPORT NEWS INVESTIGATION FIT SQUARELY WITHIN UNITED STATES V. DONDICH...... 17
  1. Adkins and Paulisch, like Zanides, effectively terminated their agency matters prior to active participation in the grand jury.. 19
  2. Ms. Adkins, like Zanides, made no criminal recommendation.. 21
  3. No claims of misconduct or abusive tactics were made against Zanides and none have been made against Ms. Adkins and Mr. Paulisch..... 21
- C. DONDICH PROPERLY DISTINGUISHED GENERAL MOTORS. THIS COURT, APPLYING THE SAME LINE OF ANALYSIS, SHOULD HOLD THAT GENERAL MOTORS IS TOTALLY........ 24 INAPPOSITE HERE.
- D. RECENT JUDICIAL DECISIONS AND RULE 6(e) ENCOURAGE MS. ADKINS' AND MR. PAULISCH'S PARTICIPATION IN THE GRAND JURY INVESTIGATION SO THAT THE GRAND JURY MAY USE THE INFORMATION DEVELOPED BY THE NAVY.. 32
- E. EVEN IF GENERAL MOTORS APPLIED TO THE FACTS OF THE NEWPORT NEWS INVESTIGATION, THE DECISION IS WRONG AND SHOULD NOT BE FOLLOWED................. 35
  1. General Motors "did not sufficiently concern itself with the appropriate role of the Federal Court in the re-examination of Grand Jury proceedings."..................... 37
  2. General Motors ignores the fact that both the Congress and the Supreme Court support active participation by agency attorneys in Grand Jury investigations. Thus, there can be no conflict of interest between the Navy and the Department of Justice in matters involving fraud..................... 38
  3. General Motors Misapplied or Misconstrued the ABA Code of Professional Responsibility and Its Prosecution Standards................ 40
  4. General Motors Erred in Assuming that any "Axe" Carried by the Agency Lawyer is Necessarily Sharper than the Assistant United States Attorney's..................... 42

Page

5. General Motors Overlooked the Availability of Less Radical Means for Preserving the Integrity and Secrecy of the Grand Jury..... 43

F. BRANIFF AIRWAYS AND OTHER DECISIONS DEALING WITH GRAND JURY WITNESSES OR OBSERVERS ARE INAPPOSITE TO THE FACTS IN THE NEWPORT NEWS INVESTIGATION... 46

V. CONCLUSION.................................. 50

IN THE UNITED STATES DISTRICT COURT FOR THE

EASTERN DISTRICT OF VIRGINIA

RICHMOND DIVISION

IN RE:)
)
GRAND JURY INVESTIGATION) CRIMINAL NO. 78-00083A-R
NEWPORT NEWS SHIPBUILDING)
AND DRYDOCK COMPANY)

RESPONSE OF THE UNITED STATES OF AMERICA TO MOTION OF NEWPORT NEWS FOR DISQUALIFICATION OF SPECIAL DEPARTMENT OF JUSTICE ATTORNEYS ADKINS AND PAULISCH AND FOR TERMINATION OF THE GRAND JURY PROCEEDINGS

I. INTRODUCTION

Newport News essentially argues that Special Department of Justice Attorneys Adkins and Paulisch must be disqualified because their agency's interests conflict with the Justice Department's and because they have an "axe to grind". The first contention cannot be reconciled with the history of this investigation, recent amendments to Rule 6(e), and Congressional requirements that agencies of the Executive Branch act in concert in investigating and prosecuting fraud. The second ignores the early involvement of the Justice Department in this investigation, the lack of any recommendation by the Navy for criminal prosecution, the effective termination of related agency matters involving the Special Attorneys prior to their active participation in the grand jury, and the absence of any allegations by Newport News that the two former agency attorneys engaged in illegal or improper tactics in their conduct of Navy matters. It is legally irrelevant that Ms. Adkins and Mr. Paulisch formerly worked on Navy matters, are now compensated by the Navy while serving with another agency of the Executive Branch, that the Navy has contractual dealings with the shipyard, or that certain elements of the Navy have been more outspoken than others on the issue of fraud in military procurement. The government's affidavits amply demonstrate that this investigation is being conducted fairly, independently, and in good faith. They are more than sufficient to warrant denial of Newport News' Motion without further inquiry into the government's motivations. In Re Grand Jury Subpoenas, April, 1978, 581 F.2d. 1103, 1108 (4th Cir., 1978); United States v. LaSalle National Bank, _____U. S. _____, 98 S.Ct. 2357 (1978). Only if Ms. Adkins and Mr. Paulisch were accused of personal misconduct in their prior dealings with the shipyard (they had none) would the issue of disqualification be properly before this Court. This investigation, like that in United States v. Dondich, 480 F.Supp. 849 (N.D. Cal., 1978) is not such a case.

II. QUESTION PRESENTED

Whether attorneys for one agency of the Executive Branch, which has referred allegations of criminal fraud to another, must be disqualified from participation as Special Department of Justice Attorneys in the grand jury proceedings solely by reason of their agency association, where there is no conflicting civil litigation or any allegations that the former agency attorneys engaged in illegal or abusive conduct.

III. COUNTER-STATEMENT OF FACTS

Criminal Fraud Section of Department of Justice Opens Preliminary Inquiry

1. On or about 29 July 1976 Attorney General Edward H. Levi received advice from the Joint Economic Committee of the Congress of the United States that evidence developed by that committee suggested "a clear possibility that the claims of one of the shipbuilders, Newport News Shipbuilding, a division of Tenneco, may be based on fraud." (Kurimai Affidavit and Exhibit A thereto)

2. In August 1976 Attorney Calvin Kurimai of the Criminal Division, Fraud Section, opened a preliminary investigation into the question whether Newport News' claims are based on fraud. (Kurimai Affidavit)

3. In early September 1976, Mr. Kurimai contacted the Navy Department. He talked with Ms. Saundra J. Adkins, Assistant to the General Counsel of the Navy. The General Counsel by regulation acts as Navy Department's liaison with the Department of Justice. Ms. Adkins was at that time the member of the General Counsel's staff who served as point of contact with the Department of Justice for criminal law matters. (Kurimai Affidavit and Adkins Affidavit)

4. Mr. Kurimai determined that the preliminary inquiry could not be completed until the Navy had completed technical analysis of the claims. (Kurimai Affidavit and Adkins Affidavit)

5. The claims had, in July 1976, been assigned within Navy to a special board, designated the Navy Claims Settlement Board, which held exclusive authority to examine the claims, make settlement offers and, failing successful settlement negotiations, to issue Contracting Officer's Final Decisions. Under the terms of the contracts out of which the claims arise, the parties agree that any claim shall be examined by the contracting officer (in this case the Chairman of the Navy Claims Settlement Board (NCSB), Rear Admiral Francis F. Manganaro) for determination of entitlement and offer of settlement. If the contracting officer and the contractor cannot agree as to the change in contract price

warranted by the contractor's claim, then the contractor has the right to bring this dispute to the Armed Services Board of Contract Appeals (ASBCA) for resolution. The ASBCA is a quasi-judicial administrative tribunal authorized by contract and regulation to exercise the judgment of the Secretary of the Navy in contract disputes. The contractor has a right to appeal the ASBCA's decision to the Court of Claims under the Wunderlich Act for review as to sufficiency of evidence to support the decision.* (Manganaro Affidavit)

6. The procedure required by regulation and followed by the NCSB in its examination of the claims involve a multidisciplined approach. Engineers conduct fact finding investigations, analyze their findings, and prepare technical advisory reports (TARs). TARs provide the Contracting Officer factual bases for his decision. Attorneys advise TAR writers as to legal aspects of the claim and of the engineer's findings. Attorneys make recommendations to the Contracting Officer including assessment of the Navy's likelihood of success should the claim be appealed to the ASBCA. DCAA auditors provide the Contracting Officer information concerning pricing. (Manganaro Affidavit)

7. From September 1976 to May 1977, Mr. Kurimai continued to contact Ms. Adkins to learn about the status of the Navy's claim evaluation process and to acquaint himself with the claims and Navy contracting procedures. (Kurimai Affidavit and Adkins Affidavit)

8. In May 1977 Ms. Adkins informally advised Mr. Kurimai that one claim item had become the subject of a referral to the Inspector General (IG) of the Naval Sea Systems Command (NAVSEA). The engineers examining that claim items had concluded that their findings and the statement of facts made in the claim were so disparate as to require referral of the matter to the IG in accordance with NAVSEA regulations. Mr. Kurimai reviewed the matter, discussed it with the engineers who had raised the question whether the claim was false and advised Ms. Adkins that

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* - Under the Contract Disputes Act of 1978, effective 1 March 1979, the Government has a right of appeal to the Court of Claims.

formal referral to the Department of Justice would not be appropriate. Navy made no formal referral at that time. (Kurimai Affidavit and Adkins Affidavit)

9. A meeting was held in June 1977 between representatives of the United States Attorney's Office, the Fraud Section, Criminal Division of the Department of Justice and the Office of General Counsel of the Navy. As a result of that meeting it was decided that a team of Navy attorneys would be set up to review the work of the technical analysts and determine if any items warranted referral to the Department of Justice.(Adkins, Kurimai, West Affidavit

10. Ms. Adkins was directed by the General Counsel to make this review along with other attorneys from the Office of General Counsel. (West Affidavit and Adkins Affidavit)

11. Ms. Adkins and the other attorneys reviewed the allegations of fraud but did not themselves initiate any allegations. The allegations were brought to the General Counsel's attention by Navy personnel who had prepared the TARs or by the NCSB or Supervisor of Shipbuilding at Newport News on behalf of persons who prepared TARs under their direction. The review took the form of examining referral memoranda, claims, TARs, and documents relied upon by the TAR writer. Ms. Adkins and the other attorneys discussed the allegations with the TAR writers who had reported them. Ms. Adkins and the other attorneys made no attempt to obtain documentation from Newport News or to interview Newport News employees. In late January and early February 1978, they reported their findings to the General Counsel. They advised the General Counsel that because the Navy lacked the authority to investigate by subpoenaing Newport News documents and interviewing Newport News employees that the Navy could not determine whether false claims had been submitted. For this reason they recommended to the General Counsel that he formally refer the allegations they had examined to the Department of Justice. (Adkins Affidavit)

12. On 6 February 1978 and 6 March 1978, the General Counsel of the Navy formally referred the allegations to the

Department of Justice for action. The General Counsel intentionally made no prosecutorial recommendation.

Criminal Fraud Section of DOJ Expands Preliminary Inquiry Into Criminal Investigation

13. After receipt of the Navy's letters of 6 February and 6 March 1978, Department of Justice assigned the matter to Attorney Joseph Covington of the Criminal Fraud Section. (Covington Affidavit)

14. DOJ Attorney Covington requested that Ms. Adkins attend a meeting at his office with DOJ Attorney James Graham, Chief of the Government Fraud Branch, for the purpose of explaining the Navy's findings and answering his and Mr. Graham's questions. The meeting was held on 8 March 1978. (Covington Affidavit, Graham Affidavit, Adkins Affidavit)

15. After that meeting DOJ Attorneys Graham and Covington concluded that sufficient facts existed to warrant further investigation. Neither Ms. Adkins, Mr. Paulisch nor any other Navy personnel participated in the making of the decision to conduct a formal Department of Justice criminal investigation. (Covington Affidavit and Graham Affidavit)

16. Upon concluding that the matter merited investigation, the Department of Justice undertook to establish a Department of Justice-Navy task force to conduct the investigation. To this end, DOJ Attorney Mark Richard, Chief of the Fraud Section, asked the Navy General Counsel to make attorneys available to Department of Justice for assignment as Special Attorneys of the Department of Justice. While the General Counsel was considering this request, he received directions from the Deputy Secretary of Defense to make attorneys available for reassignment to Department of Justice. The Deputy Secretary had agreed to provide Department of Justice with 25 Department of Defense attorneys in order to bolster Department of Justice's insufficient staff. On 28 March 1978, the General Counsel assigned Mr. Paulisch and Ms. Adkins to the Department of Justice. (Graham Affidavit, West Affidavit, Adkins Affidavit)

17. The Department of Justice assigned Ms. Adkins and Ms. Paulisch to the Criminal Division, Fraud Section.

18. Thereafter, the U. S. Attorney for the Eastern District of Virginia took over formal direction of the Newport News investigation. DOJ Attorneys Covington, Adkins, and Paulisch were assigned as Special Attorneys for the Eastern District of Virginia in order to participate in the Newport News investigation. (Covington Affidavit, Norman Affidavit)

19. Deputy Attorney General Benjamin R. Civiletti, in testimony before the Subcommittee on Crime, Committee on the Judiciary, House of Representatives, on 12 July 1978 advised the Contress that prosecution task forces had been established to investigation naval procurement fraud.

United States Attorney for the Eastern District of Virginia Decides to Request A Grand Jury Investigation

20. After preliminary investigation by the task force assigned to the Newport News case had been completed, Assistant U. S. Attorney Eliot Norman, charged with directing the investigation, recommended to the U. S. Attorney for the Eastern District of Virginia, William Cummings, that the matter be considered by a grand jury. Mr. Cummings accepted Mr. Norman's recommendation and they requested this Court to establish a grand jury to hear this and other matters involving possible violations of fraud and false claim statutes. Neither Ms. Adkins nor Mr. Paulisch participated in the U. S. Attorney's decision to request a grand jury to investigate the Newport News matter. (Norman Affidavit and Covington Affidavit)

21. The grand jury established by this court was empaneled on 18 October 1978. The grand jury has been meeting on the first and third Wednesday and Thursday of each month.

Ms. Adkins' and Mr. Paulisch's Conduct Creates No Appearance of Conflict of Interest

22. In July 1976, Ms. Adkins, then Assistant to the General Counsel of the Navy, was assigned to serve as lead attorney on the CVN 68/69 claim. In this capacity she gave advice to engineers

responsible for conducting fact-finding inquiries into the claim allegations. She gave them advice both orally and in writing. She reviewed preliminary reports of their findings to assure factual support, logical consistency and legal relevancy of matters set forth therein. She prepared legal memoranda setting forth the legal consequences flowing from their findings and making recommendations as to whether Newport News might be entitled to additional compensation on account of allegations raised in the CVN claim. She frequently discussed legal issues arising out the CVN claims with the members of the NCSB. She did not, however, participate in the Board's decision-making regarding the claims.

23. In February 1977, Ms. Adkins discontinued serving as CVN claim lead attorney and returned to her duties as Assistant to the General Counsel.

24. Mr. Paulisch was assigned in late 1976 to work with the NCSB. He served initially as Assistant Counsel to the technical team evaluating the CVN 68/69 claim. After Ms. Adkins was returned full-time to her duties as Assistant to the General Counsel, he took over the position of lead counsel on the CVN claim. His duties in connection with the NCSB were to review the various items of the claim along with the technical analysis team and advise as to questions of contract interpretation as these might arise, and to cover the technical analysis report to the NCSB with a memorandum pointing up legal issues presented, with his recommendations.

25. Neither Ms. Adkins nor Mr. Paulisch participated in the NCSB's decisions concerning the CVN claim or any other matters.

26. The Newport News Shipbuilding data and documents to which Ms. Adkins and Mr. Paulisch had access during the NCSB evaluation were limited to data and documents which were furnished by Newport News Shipbuilding as supporting material to the requests for adjustment. This material was either submitted by Newport News along with the requests or was furnished to the NCSB under an informal arrangement whereby Newport News may provide addi-

tional supporting data in response to requests of the analysis teams should Newport News choose to do so. Other than the Newport News data and documents provided as above, or such documents and data normally furnished to the Navy during the course of the contract, they had no other mode of access to Newport News data in the course of their assignments with the Navy Claims Settlement Board.

27. From September 1976 to March 1978, Ms. Adkins served as DOJ's point of contact within Navy for matters concerning DOJ preliminary inquiry into possible fraud regarding the Newport News claims.

28. As a result of the June 1977 Department of Justice - Navy meeting at the direction of the Navy General Counsel West, Ms Adkins reviewed allegations of possible fraud in connection with the Newport News claims. In early February 1978, she made her final report on the Newport News matter to then General Counsel West.

29. On March 8, 1978 Ms. Adkins participated in a meeting called by the Criminal Fraud Section answering the questions of Attorneys Graham and Covington concerning the Newport News matter. This event concluded Ms. Adkins' involvement as a Navy attorney with the Newport News claims.

30. Neither Mr. Paulisch nor Ms. Adkins at any time during their association with the Office of the General Counsel of the Navy appeared as counsel of record, nor assisted such counsel in any civil or administrative proceedings involving the Newport News claims which are subjects of the criminal investigation to which they are presently assigned by the Department of Justice.

31. Since their assignment to the Department of Justice, neither Ms. Adkins nor Mr. Paulisch have reported to anyone in the Office of General Counsel of the Navy, their only contact with the Navy has been continued payment of their salaries. (West, Szervo, Paulisch and Adkins).

32. Subsequent to their assignment to the Department of Justice, Department of Justice Attorney Joseph Covington instructed Ms. Adkins and Mr. Paulisch on criminal procedure including the basic concept of grand jury secrecy.

33. Since August 1978, Assistant United States Attorney Eliot Norman has been lead attorney on the Newport News case. In that capacity his duties have included:

> (1) writing and review of all pleadings; (2)providing tactical and legal advice to staff attorneys and agents concerning witnesses, Fed. R. Crm. Pro. 6(e), and other grand jury related matters; (3) providing guidelines and written directives to the staff concerning the direction and scope of the investigation; (4) draft-ing or editing all subpoenas for documents; (5) handling all correspondence with attorneys for individuals and Newport News Shipbuilding (NNS); (6) handling all negotiations with said attorneys regarding compliance with document subpoenas,

> appearances of witnesses before the grand jury, etc.; (7) representing the United States in hearings or chambers conferences before this Court; (8) preparation and coordination of requests for investigative assistance from the F.B.I. and other agencies; (9) preparation of all praecipes for subpoenas issued by this Court; (10) review of all requests from staff attorneys and agents for subpoenas of witnesses and for documents; (11) after consultation with other Assistant United States Attorneys, staff attorneys and the grand jurors, scheduling of grand jury sessions; (12) providing legal advice to the grand jury and responding to their questions regarding the overall conduct of the investigation; (13) questioning of witnesses before the grand jury; and (14) reporting on a regular basis to the United States Attorney and his principal Assistant United States Attorneys on the progress of the investigation.

34. Assistant United States Attorney Norman has worked closely with Ms. Adkins and Mr. Paulisch directing them on a daily basis about matters of policy and practicality arising out of the grand jury investigation. He has reviewed with them the scope of their planned questioning of witnesses before the grand jury and has often followed up questioning of witnesses as to whom either Ms. Adkins or Mr. Paulisch had conducted primary questioning.

35. A review of the record of the grand jury reveals that Assistant United States Attorney Norman, not Ms. Adkins nor Mr. Paulisch, questioned most of the witnesses and created the largest number of pages of transcript. The record reveals:

Staff Attorney	Number of Witnesses Questioned	Number of Pages of Transcript
Norman	30	845
Adkins	23	313
Paulisch	13	253
Covington	10	138

36. Of the 23 witnesses questioned by Ms. Adkins, Department of Justice Attorney Covington or Assistant United States Attorney Norman also questioned sixteen. Of the 13 witnesses questioned by Mr. Paulisch, Department of Justice Attorney Covington or Assistant United States Attorney Norman also questioned six.

37. Only one session of the grand jury was held with neither Assistant United States Attorney Norman nor Department of Justice Attorney Covington in attendance. On that one occasion, the only witnesses were FBI and NIS agents assigned to the Newport News investigation.

38. Throughout the life of the grand jury advisory and explanatory statements made by each attorney have been recorded. Each attorney has repeatedly reminded the grand jurors that such statements made by an attorney are not evidence.

39. By letter of 25 January 1979, Newport News specifically agreed that employees of the Navy and other federal agencies "as are deemed necessary by the Department of Justice attorneys to assist them in the performance of their duties to enforce federal criminal law will have access to "documents subpoenaed by the grand jury and located by agreement at a depository in Newport News. That agreement further provides that the requirements of Rule 6(e) shall apply to the use and disclosure of any document placed in the depository.

40. Numerous 6(e) notice have been filed with the Court.

41. Ms. Adkins and Mr. Paulisch by their affidavits have stated under oath that each has complied with the rules of criminal procedure in participation in the grand jury proceedings.

42. They further have sworn that they have not attempted to influence the testimony of any witness, either directly in conversation with the witness or by conversation with anyone within the Navy.

43. They have also sworn that they have had no conversations with anyone within the Navy concerning the substance of any witnesses' testimony except the witnesses themselves.

44. Rear Admiral Manganaro by his affidavit states on his oath that he has not been influenced and to his knowledge no Navy personnel called to testify before the grand jury have been influenced by Ms. Adkins or Mr. Paulisch's participation in the grand jury investigation.

45. Any recommendation for or against presenting an indictment to the grand jury will be subject to the approval of the United States Attorney for the Eastern District of Virginia and of the Major Case Review Committee of the Fraud Section, Criminal Division, Department of Justice.

The Navy Has No Economic or Political Interest in Having an Indictment Brought Against Newport News Shipbuilding

46. Rear Admiral Frank Manganaro, Chairman of the Navy Claims Settlement Board, by his affidavit states on his oath that the Navy's objective of fairly evaluating and settling its claims with Newport News has been accomplished in the best interest of the Navy. The contract modifications setting forth the terms of the settlement agreed to by Newport News and the Navy on 5 October 1978 clearly state Navy's interest in the claims. As regards possible fraud or false claims, the Navy's interest is expressed at paragraph 10 of the modification's terms which states, in part:

> ". . . the following rights are hereby reserved, it being expressly agreed that the parties do not thereby acknowledge liability therefor:
>
> (a) All rights and entitlement which the government may have against the Contractor founded upon P. O. 87-653, [Truth in Negotiation Act] to the extent that Certificates of Current Cost and Pricing Data have been provided in connection with this modification; and 31 U.S.C. 231; 18 U.S.C. 286; 18 U.S.C. 287; and 18 U.S.C. 1001."

This language was obviously included in the modifications because of both Navy and Newport News' awareness that the claims were subjects of investigation as regards possible fraud.

47. Rear Admiral Manganaro also stated on his oath that the Navy Claims Settlement Board made no criminal investigation but complied with Navy regulations pertaining to fraud by referring any irregularities found during the course of technical review to the Inspector General and the General Counsel.

48. The former General Counsel of the Navy, Togo D. West, Jr., by his affidavit states on his oath that his referral to the Department of Justice did not arise out of any political or economic interest of the Navy but was required by regulations dealing with reports to and liaison with Department of Justice on behalf of the United States Navy.

Conclusion

49. The Navy has no economic or political interest in the outcome of the grand jury's investigation of Newport News Shipbuilding and Dry Dock Company.

50. There exists no actual or apparent conflict between the interests of the Navy and that of the Department of Justice in assuring that justice be done.

51. There exists no actual or apparent conflict in Mr. Paulisch and Ms. Adkins' connection with the Navy Claims Settlement Board and their duties as Special Attorneys assigned to the Newport News investigation.

52. No actual or apparent conflict of interest arises out of Ms. Adkins' review of the fraud allegation as a member of the General Counsel's staff before their referral to the Department of Justice by the General Counsel for whatever action the Department of Justice considers warranted.

53. The Grand Jury investigation has been conducted in accordance with the law and without any appearance of impropriety or conflict of interest.

IV ARGUMENT

A. INTRODUCTION.

Newport News heavily relies upon three cases--United States v. Dondich, 460 F.Supp. 849 (N.D. Cal. 1978), General Motors Corporation v. United States, 573 F.2d 936, rev'd en banc as moot 584 F.2d 1366 (6th Cir. 1978) and United States v. Braniff Airways, Inc., 428 F. Supp. 579 (W.D. Tex. 1977)--to buttress its arguments for disqualification of Ms. Adkins and Mr. Paulisch and for termination of the grand jury.* That reliance is misplaced. Braniff and General Motors address very different factual situations while Dondich fully supports the participation of Special Attorneys Adkins and Paulisch in this investigation. Moreover, nowhere in its Memorandum does Newport News inform this Court that the wisdom of General Motors was seriously questioned by Dondich and by this Circuit in In Re Grand Jury Subpoenas, April, 1978 at Baltimore, 581 F.2d 1103, 1109n.3 (4th Cir. 1978).**

Because the facts surrounding Ms. Adkins' and Mr. Paulisch's involvement in the Newport News investigation so closely parallel those presented in Dondich, a copy of District Judge Orrick's full opinion is contained in the Appendix hereto for the Court's consideration. The United States believes that Judge Orrick's careful analysis of the "conflict of interest" cases and his practical application of the principles favoring interagency cooperation in law enforcement (See United States v. LaSalle National Bank, _______U.S._______1978) are dispositive of the issues raised by Newport News' Motion.

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*Newport News Memorandum of Law in Support of Motion for Termination of Grand Jury Investigation and for Disqualification of Saundra J. Adkins, Esquire and Eugene B. Paulisch, Esquire (hereinafter "Newport News Memorandum") at 17-22.

**Selected portions but not the holding of Grand Jury Subpoenas, April, 1978, supra are discussed in Newport News' Memorandum at 9. As discussed, pp. infra, the Fourth Circuit held that the safeguards contained in F.R.Crim.Pro. 6(e) and the government's attestations by affidavit of good faith warranted denial without an evidentiary hearing of a corporate target's motion to terminate grand jury proceedings. The target's motion, like that of Newport News, alleged misconduct by the prosecutors in permitting another agency, the I.R.S., to become involved in the grand jury process.

B. THE FACTS IN THE NEWPORT NEWS INVESTIGATION FIT SQUARELY WITHIN UNITED STATES v. DONDICH

In Dondich, Judge Orrick held that participation in the grand jury by a SEC lawyer who conducted the civil investigation of the defendants and filed civil suit against them did not present a conflict of interest nor appearance therof so as to mandate dismissal of the indictment.

The key facts in Dondich can be summarized as follows. During 1975 and 1976 SEC lawyer Mark N. Zanides conducted a SEC investigation into the sale of alleged fraudulent securities to finance development on Quimby Island, a California State reclamation district. His activities included the issuance of administrative subpoenas, the taking of depositions of two persons later indicted by the grand jury, and the analysis of evidence received from the defendants. In May 1976 Zanides recommended civil injunctive action and drafted and filed an SEC civil complaint against twenty-one persons, including the five criminal defendants. While the civil action was pending, Zanides received a request from the Department of Justice for access to the SEC investigative files. In November 1976 the files were referred to Justice without any recommendation for criminal prosecution. In the spring or early summer of 1977, Zanides met with an Assistant United States Attorney and began assisting him in the preparation of a criminal prosecution. Several months later, on 30 September 1977 Zanides was appointed a Special Department of Justice Attorney.

In the interim, by February 1977 all but two of the defendants in the civil action had consented to entry of an injunction against them. Default judgments were entered against two of the criminal defendants in January and October 1977 respectively. During 1977 Zanides also assisted other SEC lawyers in related civil cases arising out of his investigation.

During October 1977 through April 1978, Zanides presented evidence to the grand jury on no less than thirteen (13) occasions. He did not completely abandon his SEC duties, however, "During this period, Zanides remained on the staff of SEC and worked on unrelated cases in that capacity." Dondich, supra at 851.

In January 1978 one of the criminal defendants, Mortenson, filed a third party civil complaint against Zanides, other SEC officials and other public officials charging in part that Zanides' civil injunctive action had made it impossible for Mortenson to market securities, thereby causing the insolvency of his Quimby Island development. No allegations were made in the complaint of misconduct or improprieties by Zanides or any other SEC lawyers in their conduct of the civil fraud investigation itself. The complaint was dismissed in April 1978. During the entire period in which it was effectively pending, Zanides made no appearances before the grand jury. Although related civil actions did continue, the Court also found that any SEC civil injunctive proceedings against the criminal defendants "had been effectively terminated prior to Zanides' active participation in the grand jury investigation," id. at 853.

Review of these facts reveals a number of important similarities between Zanides' involvement in the Dondich case and the role of Ms. Adkins and Mr. Paulisch in the Newport News investigation. It also reveals that there have been far fewer opportunities for potential conflicts of interest to occur in the instant investigation than in Dondich. Hence, the facts in the case at bar not only square with Dondich, but fit well within its bounds.

1. Adkins and Paulisch, like Zanides, effectively terminated their agency matters prior to active participation in the grand jury.

First, like Zanides, Ms. Adkins effectively terminated her internal agency review of fraud allegations prior to her active participation in the grand jury investigation. (Mr.Paulisch did not conduct any Navy fraud inquiry.) Moreover, her review of the fraud allegations was far more limited in purpose and scope than Zanides' civil investigation.*

Second, like Zanides, the involvement of Mr. Paulisch and Ms. Adkins in any agency matters related to the grand jury investigation was also terminated well before their grand jury participation. Zanides obtained civil judgments against all the potential criminal defendants before he first presented evidence to the grand jury. Ms. Adkins and Mr. Paulisch ended their roles as legal advisors to the Navy Claims Settlement Board with respect to one (CVN 68/69) of the five claims in 1977 and March, 1978 respectively. And since the date of their active participation in the grand jury neither attorney has worked on any Navy matters whether related or unrelated to the Newport News investigation.

Newport News confuses these facts by referring to the involvement of Ms. Adkins and Mr. Paulisch in civil litigation over the claims. During the entire time that Ms. Adkins and Mr. Paulisch provided legal advice to the claims analysis effort there were no civil proceedings pending involving the CVN 68/69 claim. Further, the Affidavit of Rear Admiral Manganaro states that at no time were these attorneys or any others working in an advisory capacity to the NCSB preparing for conducting or supporting any civil or criminal litigation concerning the claims.

There can only be civil litigation if the claims submitted to the Navy are not settled. However, on 5 October 1978, two weeks prior to the first grand jury session, the Navy settled the outstanding claims including the CVN 68/69 claims for $165.9 million. $79.3 million has been paid to Newport News under the terms of the settlement agreement and an additional $92.6 million has been requested by the Navy to complete its agreement. The Affidavit of Rear Admiral Manganaro states that "the Navy considers the disputes (claims) settled and closed..." and the Navy "will be relatively unaffected by the outcome of the current Department of Justice investigation" (Affidavit at pars. 3 and 5). Only if the Navy fails to come up with the rest of the money it has already committed itself to obtain, is there the possibility of lititgation over the claims. Whether there may be civil litigation is speculative and of no relevance to the issues presented here.

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*Unlike Zanides, she did not subpoena any records or interrogate any potential criminal defendants. Instead she confined herself to review of Navy files and questioning of government employees. Also, she took no formal action. (Zanides filed a formal civil injunctive complaint against all five criminal defendants in Dondich.) Another significant factor, discussed pp.28-31infra, is that Ms. Adkins' investigation was not even as independant as Zanides' but was conducted with the advice and under the general guidance of Department of Justice Attorney Kurimai. (See Affidavit of Mr. Kurimai, attached hereo.)

Newport News also makes much of the existence of an agreement between two agencies of the executive branch under which the Department of Defense will continue to fund Ms. Adkins and Mr. Paulisch's salaries while they are employed as Special Department of Justice Attorneys. What is really important is not who pays their salaries but the fact that since their appointment as Department of Justice Special Attorneys Paulisch and Adkins have made no reports to, nor have they received any directions from anyone connected with the Navy. They now receive all direction and general supervision from the United States Attorney assigned to the Newport News investigation. In Dondich, the Court found no conflict of interest in the fact that Zanides remained on the SEC staff working on other cases, whereas Paulisch and Adkins have completely terminated their activity with the Navy Office of General Counsel. To sum up, it is apparent that the danger of any improper commingling of the civil with the criminal is even more remote than it was in Dondich.

2. Ms. Adkins, like Zanides, made no criminal recommendation

Like Zanides, Ms. Adkins made no recommendation for criminal prosecution to the Department of Justice. Her affidavit and that of former Navy General Counsel Togo D. West, Jr. explains that the term "for action" used in the referral mamoranda was merely intended to encompass whatever actions the Department of Justice considered appropriate, including termination of the inquiry. No specific recommendations were made by Ms. Adkins or her superiors as to he proper course of conduct to be taken by the Department of Justice. The affidavit of the Chief, Government Fraud Branch, Fraud Section, Criminal Division, Department of Justice, James J. Graham, states that once the referrals were made, no Navy lawyers, including Ms. Adkins and Mr. Paulisch, had a hand in his decision to expand an already existing Department of Justice preliminary inquiry into a full criminal investigation. Even after Ms. Adkins and Mr. Paulisch were appointed Special Department of Justice attorneys, they played no part in the decision to recommend to the U. S. Attorney that he approach the Court and request that a Grand Jury be enpaneled. (See Affidavits of Department of Justice Attorney Joseph J. Covington and Assistant United States Attorney Eliot Norman).

3. No claims of misconduct or abusive tactics were made against Zanides and none have been made against Ms. Adkins and Mr. Paulisch.

Neither the defenant in Dondich nor Newport News have made any claim that abusive tactics were used by the agency in its investigation. Although a third party civil complaint was filed against Zanides for damages arising out of the SEC injunction, Judge Orrick was careful to note that the suit was frivolous and did not allege that Zanides "engaged in or directed sbusive, illegal, or improper investigatory techniques..." Dondich, supra at 858. The Court also noted that Zanides' absolute immunity as a public prosecutor would eliminate any motivation on his part to use the grand jury to gain advantage in the civil suit," id. at 853 n.8. In addition, the civil suit was not effectively pending during the time period that Zanides appeared before the grand jury.

Ms. Adkins and Mr. Paulisch do not stand in any different position. No one has alleged during the pendency of this grand jury or at any time that they used abusive tactics in connection with their giving of advice to the Navy Claims Settlement Board (NCSB)* or in connection with Ms. Adkins' internal review of the fraud allegations.** At least in Dondich, Zanides and other SEC officials were named as defendants in a third party civil complaint. Neither the Navy nor any Navy officials or attorneys have been sued by Newport News for their actions in connection with the handling of the claims. Additionally, no complaint against Ms. Adkins and Mr. Paulisch alleging ethical violations has been filed with the Virginia State Bar.

Nonetheless, Newport News argues in its Memorandum at 22 that because it intends to present evidence of Nuclear Propulsion Branch misconduct to the grand jury, the Dondich Court, if faced with the facts in the instant case, would require disqualification of Ms. Adkins and Mr. Paulisch. On that same page Newport News cites dicta from Dondich that:

> Where serious allegations are made that a former agency attorney, now serving as special prosecutor, engaged in or directed abusive, illegal, or improper investigatory techniques, disqualification may be appropriate.

Id., at 853, (emphasis added). Newport News, however, has chosen to ignore the nature of its allegations and the obvious limitations of that passage: ie., that it applies only where the prosecutor is the object of the charges.

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*Any possible allegation of improper conduct by the NCSB in settling the claims is disposed of by Rear Admiral Manganaro's Affidavit, Paragraph 3.

**In fact, the only advice Ms. Adkins ever gave the NCSB regarding fraud was to tell them to go right ahead and settle the claims regardless of the merits of the fraud allegations. Such advice, far from being improper, directly benefited the monetary interestsof Newport News.

The evidence that Newport News intends to present to the grand jury is that one branch of the Navy (for which Ms. Adkins and Mr. Paulisch have never been employed) has "misled Congress" and "has over-reached and been guilty of misconduct in its dealings with the shipyards." (Memorandum at 27-28). Whether these recent allegations are even relevant evidence, let alone the type of exculpatory evidence that Newport News might be permitted to present to a grand jury, the charges clearly do not involve Ms. Adkins and Mr. Paulisch and have not been "effectively pending" during the life of the grand jury, see Dondich, supra at 851 n.4, 853.

Before this Court can adopt Newport News' distorted reading of Dondich, it must be pursuaded that Ms. Adkins and Mr. Paulisch are acting in bad faith, that its allegations are per se sufficient to vitiate the grand jury's work of the last six months, that it is really the Nuclear Propulsion Branch of the Navy (headed by Admiral Rickover) and not the Department of Justice that is presenting evidence to the grand jury, and that the Court in Dondich didn't mean what it said when it held that even a civil suit for damages against the special prosecutor would not be sufficient to disqualify his appearance before the grand jury.

Perhaps the real thrust of Newport News' argument is that somehow Ms. Adkins and Mr. Paulisch can be deemed to have violated their oath to this Court because while at the Navy they came into contact with employees of Admiral Rickover. Until it received Newport News' Memorandum, however, the United States thought that the concept of guilt by association, innuendo and hearsay was an historical relic from the days of the infamous Senate Internal Security Committee Hearings, Roy Cohn and the then Junior Senator from Wisconsin. Newport News' reading of Dondich is wrong and its argument is wholly without merit.

C. DONDICH PROPERLY DISTINGUISHED GENERAL MOTORS. THIS COURT, APPLYING THE SAME LINE OF ANALYSIS, SHOULD HOLD THAT GENERAL MOTORS IS TOTALLY INAPPOSITE HERE.

The defendant in Dondich, armed with the facts relating to SEC attorney Zanides, argued that the panel decision in General Motors Corp. v. United States, 573 F.2d, 936 (6th Cir., 1978)*, compelled dismissal of the indictment because of the creation of at least the appearance of a serious conflict of interest. However, Judge Orrick found the facts in General Motors, supra, to be "very different" from those in Dondich. From the following summary of the facts in General Motors and Judge Orrick's analysis of the General Motors panel decision, it will be equally clear that General Motors is "totally inapposite" to the Newport News investigation.

In General Motors the I.R.S. attorney, Piliaris, wrote the Justice Department recommending a grand jury investigation after GM refused to respond to certain civil discovery requests. His letter indicated that the I.R.S. intended to seek access to grand jury evidence for use in concurrent civil proceedings. "It was thus apparent that the I.R.S. planned to handle the GM civil tax matter in coordination with the grand jury investigation," Dondich, supra at 852.

After Piliaris was appointed a Special Department of Justice Attorney and appeared before the grand jury, GM complained to the prosecutors about allegedly abusive tactics by the I.R.S. "in the course of the civil investigation in which Piliaris had participated," Dondich, supra at 852. The 6th Circuit panel found that Piliaris' participation created "the appearance of a conflict of interest serious enough to terminate the grand jury, General Motors, supra, 573 F.2d, 936, 942, 945.

In Dondich, Judge Orrick pointed out that in reaching its holding "the 6th Circuit emphasized three circumstances which, in its view, justified the result," Dondich, supra at 852:

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*Dondich was decided prior to the en banc decision in General Motors Corp. v. United States, 584 F.2d, 1366 (6th Cir., 1978) which reversed the panel decision on other grounds fand thus upheld the District Court's original Order denying General Motor's Motion to disqualify an I.R.S. attorney and to terminate the Grand Jury.

> The Court's most important objection was to the possibility that Piliaris could obtain evidence generated by the grand jury for use by the I.R.S. in civil proceedings. Stressing the impropriety of "using criminal procedures to elicit evidence in a civil case," the court indicated that Piliaris' access to secret grand jury hearings placed him "in a conflicting and intolerable position." Id. at 942 943. The court appeared to view Piliaris' participation in the criminal proceeding as a means by which to further the I.R.S. civil investigation--a role clearly at odds with his duties as a prosecutor.
>
> Second, the court was concerned that Piliaris, who had actively participated in the I.R.S. civil investigation, and had himself recommended a criminal investigation, might be excessively interested in having the grand jury return an indictment which could serve to justify his own actions. Id. at 943...(T)he possibility that Piliaris could be so motivated constituted according to the court, the appearance of a conflict of interest, in violation of Canon 9 of the Code of Professional Responsibility and of Standard 12 of the Standards Relating to the Prosecution Function.
>
> Third, the fact that Piliaris had actively participated in the civil investigation made it unlikely according to the court, that he would be properly receptive to General Motors' complaints concerning abusive investigatory tactics.

Dondich, supra at 852-853. Judge Orrick held, however, that none of these three factors were present in Dondich.

First, unlike the "concurrent investigation" situation in General Motors, in Dondich all substantive SEC proceedings against the defendant had been "effectively terminated" prior to the SEC lawyer's active particpation in the grand jury investigation. Thus, there was no reason to believe that the agency intended to seek access to grand jury evidence for its own administrative or civil purposes.

Similarly, in the Newport News investigation, there is no credible threat that Ms. Adkins or Mr. Paulisch will use the grand jury as a "short cut to goals otherwise barred or more difficult to reach." United States v. Proctor & Gamble Co., 356 U.S. 677, 683 (1958) cited in Dondich, supra at 858. Although Newport

News asserts in its Memorandum at 20 that "an obvious danger exists that the involvement of the two Navy attorneys in the grand jury investigation will result in the improper co-mingling of the criminal and civil litigation..." this allegation ignores several obvious facts. There can be no "obvious danger" where there is no pending civil investigation, and only a remote chance of future civil litigation arising out of the claims. In addition, Rule 6(e) provides adequate safeguards against any violation of grand jury secrecy, *Grand Jury Subpoenas, April, 1978*, 581 F.2d 1103, 1108-1110 (4th Cir., 1978); *Dondich*, *supra* at 857-858. In this regard, the Affidavits of Assistant United States Attorney Norman, Ms. Adkins and Mr. Paulisch establish their good faith compliance with Rule 6(e). Finally, unlike Piliaris in *General Motors* and even Zanides in *Dondich*, Ms. Adkins and Mr. Paulisch have not been and will not become involved in any related or unrelated Navy matters or litigation during their tenure as Special Department of Justice Attorneys, see, e.g., Affidavits of AUSA Norman, Togo D. West, Jr., Navy Deputy General Counsel Szervo, Ms. Adkins, and Mr. Paulisch, pp.10-11, *supra*. The plain truth of the matter is that the Grand Jury can't be used as a "short cut to goals otherwise barred" because those goals don't exist.

Second, Judge Orrick didn't think much of the "axe to grind" reasoning adopted by the 6th Circuit to disqualify Piliaris. Zanides, unlike Piliaris, made no recommendation for criminal prosecution to the Department of Justice. This fact plus his past participation in a successful injunctive action made it far less likely that Zanides would have "an axe to grind". More importantly, "to the extent Zanides did have an interest in seeing the investigation produce a successful prosecution, it is unclear in what way he differs from any zealous prosecutor," *id*. at 853.

Third, unlike Piliaris, Zanides' conduct in investigating the defendants was not called into question for abusive tactics. And the pendency of a civil complaint for damages against Zanides and other SEC officials was held insufficient to influence his behavoir before the grand jury.

As discussed, pp.21-23 supra, the same two distinctions can be drawn between Pilaris and the two Special Attorneys. Their conduct is also not under attack and they made no recommendations for criminal prosecution.**

After reviewing these three factors--Zanides' effective termination of his civil SEC action, the lack of any recommendation for criminal prosecution by Zanides, and absence of any allegations by defendants of misconduct by the SEC lawyer--the Court in Dondich found "GM inapposite to the facts...and defendant's argument based thereon totally without merit." Id. at 853. Based upon the facts presented here by way of affidavit, the United States respectfully submits that this Court can similarly dispose of the Motion to Disqualify by Newport News, accord Grand Jury Subpoenas, April, 1978, supra at 1108.*

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* In its Memorandum, Newport News glosses over Judge Orrick's analysis of these three factors and goes on to argue that: "if the Dondich Court was faced with the factual circumstances in the instant case, it is submitted that Adkins and Paulisch would be disqualified...Here the civil investigation has not terminated, the agency attorney (Ms. Adkins) initiated the referral to the Justice Department, and Newport News intends to present evidence of Navy misconduct to the Grand Jury." (Memorandum at 22). Newport News well knows, however, that Ms. Adkins internal Navy investigation of the fraud allegations terminated in February and March of 1978 when the Department of Justice received the letters of referral attached to Newport News' Motion. Newport News also knows that the decision in Dondich did not turn on who made the referral but on whether Zanides' referral contained a specific recommendation for criminal prosecution. The Navy General Counsel intentionally made no such recommendations. As for the third factor, Newport News well knows that the Court in Dondich specifically held that the pendency of a suit against an agency which does not allege misconduct by the agency attorney would not require disqualification. Perhaps Newport News' motivation for giving such superficial treatment to Dondich is that it is so unfavorable to the shipyard position. Be that as it may, the opinion deserves a fairer summarization than the one found in Newport News' Memorandum at 22.

**The referrals were actually made by Navy General Counsel Togo D. West, Jr. In Paragraph 8 of his Affidavit, he explains that: "The Navy's referral of these matters to the Department of Justice did not arise out of any political or economic interest in any potential criminal investigation or prosecution but was required by statute and regulation."

Furthermore, the facts pertaining to Ms. Adkins' and Mr. Paulisch's involvement in the Newport News investigation are even farther removed from General Motors than is Dondich. Regarding the formal referrals to Justice and Newport News' allegations of bias by Ms. Adkins, the Court may take note of the following: Ms. Adkins, unlike Piliaris, or even Zanides, was conducting a very limited inquiry whose sole purpose was to screen, review and summarize allegations of fraud initiated by technical analysts prior to formal Justice Department referral. Thus, Ms. Adkins was not in the position of a Piliaris whose civil tax investigation was actually being frustrated by GM prior to Piliaris' letter to Justice recommending a grand jury. In other words, because the Navy is not in the business of collecting back taxes, enjoining the sale of fraudulent securities or suing contractors for fraud, Adkins and Paulisch can have no "axe to grind" with this grand jury.*

Although Newport News alleges that the "facts in the instant case fit squarely with the concerns expressed in General Motors." (Memorandum of Newport News at 20.) That allegation ignores the facts of the instant case, among those facts is the substantial role of the Department of Justice in guiding the investigation in its formative stages, see Affidavit of Department of Justice, Attorney Calvin B. Kurimai. Piliaris in General Motors and even Zanides in Dondich independently initiated significant legal steps against their respective target defendants way before the Justice Department was invloved in either matter. Their actions included witness interviews, issuance of subpoenas, and in at least the Zanides' case, the drafting and filing of a civil injunctive complaint. But in the Newport News investigation, the Justice Department was in on the ground floor. Chronology of Investigation, Appendix, Ex. K.

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Mr. Kurimai opened a preliminary Justice criminal inquiry in August 1976 after receipt of a letter from Senator Proxmire. From September 1976 to May 1977 he initiated intermittent contacts with Ms. Adkins so that Justice could be kept advised of progress in the technical analysis of the claims. When this stage in the inquiry was substantially completed, a meeting was held in June 1977 with representatives of the United States Attorney's Office, the Fraud Section of the Criminal Division, Department of Justice, and the Office of General Counsel of the Navy. As a result of that meeting it was decided that a team of Navy attorneys headed by Ms. Adkins would review the work of the technical analysts to determine if any items warranted referral to the Department of Justice. Thereafter, Kurimai maintained contact with Ms. Adkins to "advise her whether certain findings by the technical analysts might warrant referral." (Affidavit of Kurimai.) During 1977, and prior to this meeting Kurimai had already investigated at least one allegedly false item and determined that it, standing alone, did not warrant referral. Finally, in February and March 1978, Mr. Kurimai received the formal referral letters which were the subject of his communications with Ms. Adkins.

Mr. West's referral letters intentionally make no recommendations for prosecution. They simply forward the written reports of Navy's review of allegations which review had previously been the subject of informal communications between Ms. Adkins and Mr. Kurimai.

Several important conclusions emerge from this chronology. The most obvious and most important is that this matter has been a Justice Department investigation from its inception. Mr. Kurimai did not open his preliminary investigation at the request of the Navy, but in response to Senator Proxmire's 29 July 1976 letter to then Attorney General Edward H. Levy. That letter, states in part:

> As you may know, Newport News has filed six claims against the Navy for a total of $894 million...I have been holding hearings on shipbuilding claims against the Navy since 1969. The Newport News claims raised the most serious questions of possible fraud than any of the claims I have seen...The purpose of this letter is to formally request that you designate a team of investigators within the Justice Department...to determine if the claims are based on fraud.

It is also clear that the genesis for the internal Navy fraud inquiry and organization of a team headed up by Ms. Adkins was not the result of some "witch hunt" by certain elements in the Navy. Rather, the team was organized as a result of a June 1977 meeting between Justice and the Navy. In turn, the 1978 formal referral letters, cited by Newport News in its memorandum as evidence of an "axe to grind" by Ms. Adkins, cannot be evidence of any such thing.*

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*First, the decision to forward the results of the Navy's review to Justice was made by the General Counsel, not Ms. Adkins. Second, Ms. Adkins's recommendation to the General Counsel that referral would be warranted was based upon the Navy's inability to conclude whether any violation of federal law had occurred because Navy lacked the authority to subpoena documents or interview Newport News employees. Third, the reports were prepared with Depart of Justice Attorney Kurimai's general advise. Fourth, The reports were referred not as a unilateral Navy action but as a result of Department of Justice coordination.

Finally, it is apparent that the internal Navy fraud inquiry was conducted with the general advice of the Department of Justice and in connection with the Department of Justice's own preliminary investigation.

To argue therefore that because of her involvement with the Navy review of the fraud allegations that Ms. Adkins cannot act as Special Attorney before the grand jury requires distortion of the facts concerning her involvement in the Navy's review. It also ignores the fact that Department of Justice, not the Navy, initiated the Newport News investigations. The facts in the instant case differ so significantly from those in General Motors as to make the holding in that case inapplicable here.

D. RECENT JUDICIAL DECISIONS AND RULE 6(e) ENCOURAGE MS. ADKINS' AND MR. PAULISCH'S PARTICIPATION IN THE GRAND JURY INVESTIGATION SO THAT THE GRAND JURY MAY USE THE INFORMATION DEVELOPED BY THE NAVY

Newport News also objects in its Memorandum at 24 to the use of information acquired by Ms. Adkins and Mr. Paulisch during their employment as Navy attorneys in furtherance of this Grand Jury investigation. Specifically, Newport News questions whether Special Attorney Adkins can ethically review her own prior "findings and conclusions" regarding the fraud allegations after she has been assigned to the Grand Jury investigation. (Those "findings and conclusions" were referred to the Justice Department in response to its prior inquiries and pursuant to its general guidance and advice.) It is of interest to note that Newport News apparently does not object to the use of Ms. Adkins' findings by other Department of Justice attorneys in preparing for grand jury sessions.*

When the Court in Dondich was faced with the same line of argument,** Judge Orrick pointed out that the SEC is authorized by regulation and statute to refer to the Department of Justice any evidence concerning potential violations of the laws against fraud. Accordingly, Judge Orrick had great difficulty understanding "how the participation of Zanides transforms an otherwise lawful and proper exchange of information into an improper one," Dondich, supra at 854. The Court further observed that in United States v. LaSalle National Bank, _____ U.S. _____, 98 S.Ct. 2357 (1978), which was decided after the panel decision in General Motors, Mr. Justice Blackmun stressed the importance of inter-agency cooperation in effective law enforcement and warned against any unrealistic attempts to build artificial barriers between two agencies of the Executive Branch, LaSalle National Bank, supra at 2367, cited in Dondich, supra at 854.

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*As stated, p. 30 supra, those findings consist mainly of factual summaries and do not make any conclusions as to the possible existence of fraud.

**In Dondich, the defendant argued that Zanides' participation in the Grand Jury was improper because it enabled him to use evidence he developed during the course of his SEC civil investigation.

The same policy considerations apply to the relationship between the Navy and the Justice Department. Although Newport News argues in its Memorandum at 26 that referrals from the Navy should be distinguished from referrals made by I.R.S. and the SEC because the latter are purely investigative agencies, Congress makes no such distinction. As explained in former Navy General Counsel Togo West's Affidavit, the Navy is required by statute and regulation to refer allegations of fraud to the Justice Department. Nor is there any indication whatsoever in LaSalle National Bank that the Supreme Court intended to limit its ruling to the IRS.

To accept Newport News' position would create precisely the artificial barriers opposed by the Supreme Court. Consider the following scenario: Ms. Adkins, because of Rule 6(e)*, would be free to analyze Grand Jury documents and testimony; to pass suggested questions at the door of the Grand Jury room to the Assistant United States Attorney; to interview witnesses outside the Grand Jury room; to testify as a summary witness before the Grand Jury;** and, in short, to participate in virtually every phase of the investigation and influence its course. But because of some unrealistic rule urged upon by this Court by Newport News, neither she nor Mr. Paulisch would be allowed to enter the Grand Jury room as a prosecutor despite their appointments by the Deputy Attorney General.

The Supreme Court also held in LaSalle National Bank at 2367 that an agency need act only in "good faith" in referring allegations of wrong doing to the Justice Department. This Court, based upon the government's affidavits, should hold that the referrals were made in good faith. Accordingly, the United States respectfully submits that the appropriate course of action would be to rely upon existing safeguards, such as Rule 6(e), rather than to take the radical action demanded by the shipyard. (See Grand Jury subpoenas, April, 1978, supra, 581 F.2d at 1108-10, involving a challenge to interagency cooperation in law enforcement similar to the one at bar.)

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*As discussed p.38 infra, Rule 6(e) was amended in 1976 to permit disclosure of Grand Jury evidence without a Court order to any attorney for the government and any government personnel "as are deemed necessary by an attorney for the government to assist . . . in the performance of such attorney's duty to enforce Federal criminal law."

**The use of an agency attorney as a summary witness was recently upheld by the District Court, Alexandria Division, in United States v. Randell, Cr. No. 78199A (1979).

E. EVEN IF GENERAL MOTORS APPLIED TO THE FACTS OF THE NEWPORT NEWS INVESTIGATION, THE DECISION IS WRONG AND SHOULD NOT BE FOLLOWED

As previously discussed, pp.16-17 supra, several courts in recent months have questioned whether there can ever be a conflict of interest between two government agencies in a criminal investigation in the absence of any showing or serious allegation that the personnel directly involved in the investigation have acted in bad faith or have engaged in abusive and improper tactics. See generally United States v. LaSalle National Bank, supra. The Dondich court was not convinced that the General Motors panel decision was correctly decided or that its reasoning should be adopted. The wisdom of General Motors was also questioned by this Circuit in Grand Jury Subpoenas, April, 1978, supra. The Fourth Circuit, although not reaching the conflict of interest issue raised in General Motors, cited the dissent as "more persuasive" than the majority opinion. The dissent in General Motors at 947-948 states that the majority had confused the demands of the Canon of Ethics of lawyers with the Code of Conduct of judges. "A judge should disqualify himself from a case he participated in as a lawyer, but a prosecutor should not disqualify himself because he has previously conducted other investigations of the same suspect whether for the same or different governmental agencies." Id. Accordingly, Ms. Adkins and Mr. Paulisch's involvement in the administrative and criminal aspects of the investigation constitutes "a natural, not a sinister sequence of events." Id.

Also of interest is the recent decision by this District Court, Alexandria Division, in United States v. Randell, et al., Cr. No. 78-199-A. In Randell, defendant Mumford called to the Court's attention the fact that the SEC attorney (Smoot) who brought the civil case subsequently appeared as the government's chief summary witness before the Grand Jury. Defendant Mumford moved to dismiss the indictment for securities fraud upon the grounds that Smoot's involvement in the civil and criminal aspects of the case and his dual role as SEC civil attorney and Grand Jury witness created the serious appearance of a conflict of interest under General Motors. Defendant argued that because the SEC civil suit against him was thrown out, Smoot's participation in the grand jury investigation was part of a "witch hunt" by Smoot in which he improperly manipulated the prosecutors and the grand jury to bring an unwarranted prosecution.

The government's response to these allegations principally relied upon Dondich and Grand Jury subpoenas, April, 1978. The government alleged that Smoot's involvement in Randell was no different than Zanides' participation in Dondich. Although the Court's denial of Smoot's SEC civil action against Mumford was appealed after Smoot began participating in the grand jury, Smoot had no involvement in that litigation. Thus, as far as he was concerned, his involvement in any parallel civil proceedings was effectively terminated. Smoot also had made no recommendations to the Department of Justice for criminal prosecution of Mumford. Finally, unlike the situation in General Motors, there were no claims in Randell that Smoot had used abusive tactics in conducting the SEC civil action or investigation.

The United States Attorney's Office also argued that application of the Sixth Circuit decision to this District would have serious and adverse consequences in the law enforcement area. Prior to the General Motors decision Congress had long encouraged a close working relationship between the SEC and the Justice Department. To dismiss the indictment, the government argued, would seriously hinder and lengthen grand jury investigations in the District, requiring them to duplicate the prior investigative work of agencies with the expertise to uncover complicated schemes of fraud. Judge Lewis in his pre-trial and Judge Bryan in his post-trial rulings summarily dismissed Mumford's "conflict of interest" motion.

As analyzed by Dondich and others, the Sixth Circuit panel decision in General Motors can be criticized on several grounds. Because the Newport News Memorandum relies so heavily upon the rationale in General Motors, its arguments before this Court suffer from the same basic deficiencies.

1. General Motors "did not sufficiently concern itself with the appropriate role of the Federal Court in the re-examination of Grand Jury proceedings."

The above quotation from Dondich, supra at 855 addresses the same concern that was the subject of the Fourth Circuit's opinion in Grand Jury Subpoenas, April, 1978. General Motors went too far in reversing the District Court's supervision of the grand jury proceedings and requiring their termination. As the Fourth Circuit held in Grand Jury Subpoenas, April, 1978, supra at 1108:

> [C]ourts should not intervene in the Grand Jury process absent compelling reason. Clearly, to hold an evidentiary hearing into prosecutorial motivation with an eye toward quashing otherwise lawfully issued subpoenas and even terminating the entire process would be substantial judicial intervention.

In that case, this Circuit upheld the District Court's decision to refuse to conduct an evidentiary hearing into the government's motivations in involving IRS personnel in a Grand Jury investigation. It was sufficient to rely instead upon affidavits by the Department of Justice Attorneys attesting to their good faith. Further, this Circuit saw little need for the type of intervention suggested by the General Motors decision. In the Court's view, Rule 6(e) contained sufficient safeguards to fully protect the petitioner's legitimate interests and to deter any improper commingling of criminal and civil matters. Id. at 1108-1110.

The problem with the General Motors decision and with Newport News' Motion is that they ignore the availability of less drastic remedies--such as the District Court's power to punish by contempt any violations of grand jury secrecy. In this case, as in most cases, the normal supervisory powers of the Court over the attorneys appearing before it and over the grand jury are sufficient. It is, thus, surprising that nowhere in its Memorandum does Newport News even mention Rule 6(e) let alone explain why 6(e) does not fully protect its legitimate interests.

2. General Motors ignores the fact that both the Congress and the Supreme Court support active participation by agency attorneys in Grand Jury investigations. Thus, there can be no conflict of interest between the Navy and the Department of Justice in matters involving fraud.

The most serious deficiency in the General Motors decision lies in its failure "to give adequate recognition to the growing need for interagency cooperation in the enforcement of federal laws. The increasingly complex nature of federal criminal prosecutions demands that expert counsel be made available to assist the Department of Justice." Dondich, supra at 855-856; Accord, LaSalle National Bank, supra, cited in Dondich at 854.

Newport News candidly admits that the claims which are the subject matter of this investigation are "extremely complex", voluminous, and total more than one million pages if the supplementary materials are included. Newport News has already produced hundreds of boxes of back-up documents for these claims and has specifically agreed to the Justice Department's use of Navy personnel to help review them, see p. 12 supra; Affidavit of AUSA Norman, Paragraph 12. Yet, Newport News goes on in its Memorandum to urge this Court to deny to the Department the assistance of Ms. Adkins, Mr. Paulisch, and any Navy lawyers with experience in shipbuilding. This approach of denying participation in the grand jury investigation to only those persons who may provide the most effective assistance may favor Newport News' interests, but it does not square with "the public's right to the proper functioning of a grand jury investigation . . ." In Re Investigation before February 1977, Lynchburg Grand Jury, 563 F.2d 652, 655 (4th Cir. 1977). Nor does it comport with Congressional and

Supreme Court support for "active participation by agency attorneys in grand jury proceedings," Dondich, supra at 856.

Evidence of judicial and legislative support can be derived from several sources. The Report of the Senate Committee on the Judiciary explains that Rule 6(e) was redrafted in 1976 "to accommodate the belief . . . that Federal prosecutors should be able, without the time-consuming requirement of prior judicial interposition, to make such disclosures of grand jury information to other government personnel as they deem necessary . . . " S.Rep.No. 95-354, cited in Dondich, supra at 856. It is obvious that one intended result of this amendment is the encouragement of the type of agency contributions to law enforcement that Newport News now opposes. Congress would not have facilitated access to the grand jury if it considered the Navy or any other federal agency to have a conflict of interest with the Justice Department with respect to fraud on the taxpayers of the United States.

Of similar import is the Supreme Court Advisory Committee's Note on the new Rule 6(e): "[t]he proposed amendment reflects the fact that there is often government personnel assisting the Justice Department in Grand Jury proceedings." Id. And in LaSalle National Bank, the Supreme Court spoke of the importance of "encouraging maximum interagency cooperation" in enforcing complex criminal laws, 98 S.Ct. at 2365.

The most recent example of Congressional intent in this area is to be found in the Inspector General Act of 1978, effective 12 October 1978, and in its legislative history. The Act specifically addresses the Defense Department (DOD) and other agencies whose primary mission is not investigative and who may be subject to program fraud, procurement fraud, and other forms of deceit. The IG Act and its history put to rest any notions that Ms. Adkins and Mr. Paulisch's participation in the grand jury creates an appearance of conflict of interest because they are compensated by and have previously been associated with the Navy. As far as Congress is concerned, the interests of all agencies of the Executive Branch are identical when it comes to combatting fraud.

The legislative history of the I.G. Act clearly indicates that increased agency participation, including DOD participation, in the prosecution of millions of dollars of fraud in government programs is one of the central goals to be accomplished.* Senate Report 95-1071, 95th Cong., 2nd Sess., reprinted in 1978 U.S. Cong. Code & Admin. News, at 4408-4411, 4426-4427, 4432, 4435, 4442 passim. In the Senate Report entitled "LACK OF COOPERATION WITH THE JUSTICE DEPARTMENT", the Committee openly criticizes the DOD for not working "very effectively with the Department of Justice to investigate and prosecute criminal fraud in its programs." Id., at 4426.

These excerpts demonstrate Congress' intent to insure that DOD involvement in investigating fraud will not end with the statutorily required referral of suspected violations to the Department of Justice, see id., at 4426, 4435.** It is precisely such involvement which Newport News says amounts to a "conflict of interest." This argument cannot be reconciled with the purpose of an Act which chastises DOD for its past ineffectiveness and urges the agency to do more, not less, in the investigation and prosecution of these cases.

3. General Motors Misapplied or Misconstrued the ABA Code of Professional Responsibility and Its Prosecution Standards.

Newport News alleges that the appearance of a serious conflict of interest in violation of the applicable ABA Code of Professional Responsibility Cannons and Prosecution Standards has been created by Ms. Adkins and Mr. Paulisch's participation in the Grand Jury investigation. Newport News, like the Court in General Motors, misapplies these ethical standards. Dondich correctly points out that "simultaneous involvement in investigative and

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*In fact, the chief criticism leveled at the agencies in the Senate Report is that they have not been doing enough complaining and when they do complain they have not done enough to help out the Justice Department.

**When such assistance is provided under the supervision of the managing Assistant United States Attorney, as has been the case prosecutorial aspects of federal enforcement proceedings does not appear to present the kind of conflict of interest addressed by the Code or the Prosecution Standards." Id., at 856. Rather, these ethical standards were drafted to cover the problems that arise when a prosecutor leaves or enters private practice. Thus, while a new AUSA may not continue to represent his former clients for fear of raising the spector of bias or favoritism, the same concerns are absent when an attorney leaves IRS and goes to Justice as a permanent or Special Department of Justice Attorney. This is especially true where Congress has encouraged the agency to work with Justice or where they are actually acting in "concert to seek out and prevent violations of federal law." Dondich, supra at 857.

Newport News also argues that because Ms. Adkins "is now in the position, as a Special Attorney, of reviewing her own findings and conclusions, [a] clearer conflict of interest cannot be envisioned." (Memorandum at 24). If this is an ethical violation, then every prosecutor who has had to review his investigative findings and then make a decision whether to recommend an indictment to a grand jury has also created the appearance of a serious conflict of interest. The Fourth Circuit, if presented with this issue, has already indicated it would side with Judge Merritt's dissent in General Motors. In that dissent, Judge Merritt observed that the involvement of an attorney in the investigative and later prosecutive aspects of a case, regardless of his agency, constitutes "a natural, not a sinister sequence of events." General Motors at 947; Dondich, supra, at 857.

Finally, because Congress makes no distinction among agencies of the Executive Branch when it comes to combating fraud, no conflict of interest arises from the fact that Ms. Adkins and Mr. Paulisch are paid by the Department of Defense while assigned

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throughout this investigation, the Court need not be concerned about the conduct of the Special Department of Justice Attorney, see Affidavit of AUSA Norman; pp. 10-13 supra.

to the Department of Justice. Neither does any appearance of conflict of interest exist, since both these attorneys have terminated any contact with any other Navy business. See generally the Affidavits of AUSA Norman, Mr. Paulisch and Ms. Adkins.

4. General Motors Erred in Assuming that any "Axe" Carried by the Agency Lawyer is Necessarily Sharper than the Assistant United States Attorney's.

In General Motors the Sixth Circuit assumed that any IRS attorney who recommended a criminal investigation would be unduly zealous as a prosecutor. The same argument is made by Newport News: Ms. Adkins and Mr. Paulisch necessarily have an "axe to grind" because of their past involvement in analyzing the claims and because Ms. Adkins referred the allegations of fraud to the Justice Department "for action". (Newport News Memorandum at 24.)

In response to these types of allegations, Dondich essentially made two observations, both of which apply to the instant investigation: First the "axe to grind" objection "could apply to any prosecutor who has participated in a lengthy investigation prior to empanelment of a grand jury, not merely to agency attorneys who are subsequently appointed Special Assistant United States Attorneys," id, at 857.* In this regard, the Affidavit of

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*The "axe to grind" theory allegation also assumes that an Assistant United States Attorney will be less interested in allegations of fraud against the GSA or the Navy than the agency attorney. This argument ignores the fact that all government attorneys, regardless of their agency, are on an equal footing and have an equal interest in deterring and prosecuting raids on the Treasury. As far as the average Assistant United States Attorney is concerned, fraud on the Navy is nothing more and nothing less than a raid on the Treasury; and he will be as disposed to prosecute it as any ex-agency lawyer now serving as a Special Department of Justice Attorney. Newport News can claim that its alleged fraud is not on the government, just on the Navy, but this Assistant United States Attorney fails to perceive any difference.

AUSA Norman states that the conduct of the two Special Attorneys before the grand jury is no different and no less fair than that of the two Justice Department Attorneys involved in the investigation or of other Assistant United States Attorneys in the Office.

Second, Dondich criticized General Motors for confusing the canons for judges with those for prosecutors. As an advocate, a prosecutor must be fair but the standards cited by General Motors and Newport News do not require him to be neutral. Those same standards also note that "it is especially important that [the prosecutor] be free to express his opinion...to the grand jury on the weight of evidence..." Dondich, supra at 857.

Although Ms. Adkins and Mr. Paulisch have acted as advocates before the grand jury, this Court can be reassured by the manner in which they have assisted in the conduct of the proceedings. All of the staff attorneys, including Ms. Adkins and Mr. Paulisch, recognize that their most important responsibilities are as officers of the Court to insure that all witnesses are interrogated fairly, that the investigation is conducted in good faith, and that nothing is done to improperly influence the grand jurors. See Affidavits of AUSA Norman, Paragraph 6; Ms. Adkins and Mr. Paulisch. In summary, neither the appointment of Ms. Adkins or Mr. Paulisch nor their subsequent conduct has led to the appearance of any ethical violations.

5. General Motors Overlooked the Availability of Less Radical Means for Preserving the Integrity and Secrecy of the Grand Jury

Judge Orrick's final criticism of General Motors addresses the Sixth Circuit's failure to recognize and employ less radical measures to safeguard the grand jury process. Similarly, Newport News speaks of the "obvious danger" that Ms. Adkins and Mr. Paulisch will use grand jury evidence for improper purposes and hence requests disqualification and termination of the proceedings

The approach taken by General Motors and Newport News ignores the more than adequate contempt powers of the Court to punish any violations of Rule 6(e).* Grand Jury Supoenas, April 1978, supra.

The approach adopted by General Motors and endorsed by Newport News also provides a far too narrow view of the possible uses of grand jury evidence. Even if Piliaris in General Motors and Adkins and Paulisch in the instant case were to later use grand jury evidence for civil purposes, such use is perfectly proper, if (1) authorized by Order of the Court and (2) the grand jury was used for legitimate criminal investigatory purposes. The Fourth Circuit decision in GrandJury Subpoenas, April 1978, supra has established a number of detailed and elaborate criteria to be followed in reviewed requests for the release of grand jury evidence for use in other matters.** This Circuit also recognized therein at 1109 that other agencies such as the IRS have a legitimate interest in the materials secured by the grand jury. "The Government does not sacrifice its interest in unpaid taxes just because a criminal prosecution begins." LaSalle National Bank, supra 98 S.Ct. at 2365 cited in Grand Jury Subpoenas, April 1978, supra at 1109.

In any event, the Navy has not requested access to grand jury evidence nor is such a request anticipated. And the government's Affidavits are sufficient to rebut any contentions that this Court should hold an evidentiary hearing to determine whether Ms. Adkins and Mr. Paulisch have secretly manipulated the United States Attorney, two Department of Justice Attorneys, 21 grand jurors and 10 FBI Agents into conducting an investigation whose sole purpose is to give the Navy the upper hand in its negotiation of future shipbuilding contracts or some other non-criminal goal.

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*It is unlikely that any contempt proceedings will arise in this action. The Affidavits of AUSA Norman,Mr. Paulisch and Ms. Adkins establish that the investigation at all times has been conducted in compliance with Rule 6(e) and other pertinent Rules of Criminal Procedure. Mr. Norman has specifically instructed in writing all staff attorneys and agents regarding the requirements of Rule 6(e) and numerous notices have been filed with the Court.

**Instead of now moving to terminate the proceedings, Newport News can move for a protective order against disclosure of grand jury evidence if and when a 6(e) request is made. See Dondich at 858.

In conclusion, even if the facts in *General Motors* were the same as in the instant investigation, there would be substantial grounds for not adopting the Sixth Circuit's approach to the conflict of interest issue. *Accord* *Grand Jury Subpoenas, April, 1978*, *supra* at 1103 n.3. The basic problem with the *General Motors* decision and Newport News' reliance upon it is the Sixth Circuit's failure to "strike a balance which will prove effective and workable" between the "increasing need for cooperation among government attorneys and agencies" and the requirement that prosecutors act in a fair and independent manner. *Dondich*, *supra* at 855.

F. BRANIFF AIRWAYS AND OTHER DECISIONS DEALING WITH GRAND JURY WITNESSES OR OBSERVERS ARE INAPPOSITE TO THE FACTS IN THE NEWPORT NEWS INVESTIGATION.

Newport News also contends that decisions dealing with the presence of unauthorized or improper government witnesses or observers in the Grand Jury room require disqualification of Ms. Adkins and Mr. Paulisch. In United States v. Braniff Airways, Inc., 428 Fed. Supp. 579 (W.D.Tex. 1977) a former CAB official who had approved agreements that were the subject of an antitrust investigation for conspiracy attended sessions of the grand jury as an observer. The District Court raised two concerns about this former CAB official's presence: (1) as an observer he was an unauthorized person before the grand jury; and (2) as a former "high CAB official" he might have an unnecessary influence upon the grand jury, particularly where it was investigating allegedly illegal agreements that he had approved, id. at 583. Upon those and unrelated grounds the Court dismissed the indictment.

Newport News relies upon Braniff to make three arguments for disqualifying Ms. Adkins and Mr. Paulisch. First, the shipyard contends that because Ms. Adkins and Mr. Paulisch may be witnesses before the grand jury, they should be disqualified.

Unlike the CAB official in Braniff, Ms. Adkins and Mr. Paulisch did not play a part in the formulation or approval of any agreements that are alleged to be in violation of the criminal laws. And of course they had no hand in drafting the 64 volumes of Newport News claims that have been alleged to be fraudulent. In addition, their conduct while assigned as counsel to the Navy Claims Settlement Board (NCSB) analysis team is not and will not be the subject of the grand jury inquiry. In their role as legal advisors, they did not participate in any of the NCSB's decision making regarding the claims. While with the NCSB they also had no communications with Newport News. Finally, during her inquiry into allegations of fraud received from engineers and other technical employees of the Navy, Ms. Adkins did not subpoena records from Newport News or interview any of its employees. Thus, there is no reason for the two Special Attorneys to testify as witnesses before the grand jury.

Even assuming that Newport News is permitted to present to the grand jury the evidence* referred to in its Memorandum at 27-28, there is no real possibility that Ms. Adkins or Mr. Paulisch will become witnesses to rebut or confirm such proof.

For the foregoing reasons, any potential conflicts of interest created by the dual role of a prosecutor as attorney and witness in the same proceeding, see United States v. Treadway, 445 F. Supp. 959 (N.D.Tex 1978) are not and will not be present in the instant investigation.

Second, Newport News argues that while Ms. Adkins and Mr. Paulisch may not be formal witnesses, they may make statements before the grand jury which will be the equivalent of evidentiary testimony because of their background in analyzing shipbuilding claims. Newport News cites no authority for the proposition that summary comments or introductory remarks to the grand jury by two of its legal advisors are *per se* improper and require disqualification of the attorneys if those comments reflect, in part, the attorney's prior experience. In any event, the Affidavit of AUSA Eliot Norman points out that since the inception of the grand jury, the attorneys have frequently advised the grand jurors that their statements are not to be considered as evidence and must be disregarded by the grand jury in its deliberations. That Affidavit also points out that there has been only one session of the grand jury at which Ms. Adkins and Mr. Paulisch have questioned the witnesses in the complete absence of Department of Justice Attorney Covington or AUSA Norman. This Court may also take into consideration that the Fourth Circuit on two occasions has expressly upheld the summarization of the evidence for the benefit of the grand jury by the prosecutor, particularly where the grand jury might be unable to discern the significance of relevant testimony or to evaluate a great mass of documents produced before it. United States v. United States District Court, 238 F. 2d 1241 (4th Cir. 1956) cert denied sub nom., Valley Bell Dairy Co., Inc., v. United States, 352 U.S. 981 (1957); United States v. Litton Systems, Inc., 573 F.2d 195 (4th Cir. 1978). In light of the above, and because of the substantial presumption in favor of the regularity of grand jury proceedings, there are no grounds to require this Court to inspect the minutes of the grand jury to determine if any summary comments were, in fact, evidence that may taint the jurors deliberations.

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*The alleged exculpatory evidence is as follows: That the Nuclear Propulsion Branch of the Navy headed by Admiral Rickover "has misled Congress in testimony concerning the award and administration of shipbuilding contracts and that it has overreached and been guilty in misconduct in its dealings with the shipyards." Ms. Adkins and Mr. Paulisch have never worked for the Nuclear Propulsion Branch. Prior to the grand jury investigation they worked for the General Counsel of the Navy who reported directly to the Secretary of the Navy.

Again citing the Braniff decision, Newport News contends that the presence of Ms. Adkins and Mr. Paulisch in the grand jury room will unduly influence the candor of testimony of Navy witnesses and Newport News witnesses who are afraid that their testimony may eventually "leak" back to employees of the Nuclear Propulsion Branch of the Navy with which they have contractual dealings. (See Newport News' Memorandum at 16, 23.) The problem with this argument is that is assumes that Ms. Adkins and Mr. Paulisch will willfully violate their oath to this Court and violate Rule 6(e) regarding grand jury secrecy. Any suspicions of leaks or bad faith on the part of these two Special Department of Justice Attorneys are put to rest by the Affidavits of AUSA Norman, DOJ Attorney Covington, Ms. Adkins and Mr. Paulisch.

Another problem with the witness influence argument is that Ms. Adkins and Mr. Paulisch, are not in the same position as the CAB official in Braniff. In Braniff, the CAB employee was a "high ranking official" who most probably had direct dealings with one or more of the alleged conspirators or witnesses called before the grand jury. Thus, a real possibility existed that this observer could influence the testimony of lower ranking government employees. See also United States v. Daneals, 370 Fed. Supp. 1289 (W.D.N.Y. 1974). In that case there was possible undue influence arising out of the presence in the grand jury room on draft evasion cases of the Regional Counsel of the Selective Service, as an observer. Ms. Adkins and Mr. Paulisch, however, are not observers but prosecutors, fully authorized by the Deputy Attorney General and fully subject to the supervision of this Court. The Affidavit of Rear Admiral Manganaro to the effect that his testimony was not influenced in any way by the presence of Mr. Paulisch or Ms. Adkins and that no information has come to him concerning any attempts by them to influence the testimony of any Navy witness negates this fear. This affidavit and the affidavits of Ms. Adkins and Mr. Paulisch are sufficient under Grand Jury Subpoenas, April, 1978, supra to warrant rejection of Newport News' speculative contention.

The frivolousness of this contention becomes apparent when one stops to reflect that Newport News' position would require disqualification of any Assistant United States Attorney from questioning any F.B.I. agent before the grand jury because of the supposed threat that if the testimony was not good enough, the AUSA would report this fact to the agent's superiors.

Finally, unless Newport News can establish that Ms. Adkins and Mr. Paulisch are knowingly presenting perjured testimony to the grand jury, there is no legal authority permitting this Court to inquire into the sufficiency, nature or competence of the evidence presented before the grand jury by the witnesses, e.g., United States v. Costello, U.S. 359 (1956).

V. CONCLUSION

WHEREFORE, the United States respectfully requests the Court to enter an ORDER DENYING Newport News' Motion for Disqualification of Special Department of Justice Attorneys Adkins and Paulisch and for Termination of the Grand Jury Proceedings.

Respectfully submitted,

UNITED STATES OF AMERICA

WILLIAM B. CUMMINGS
UNITED STATES ATTORNEY

By: Eliot Norman
Eliot Norman
Assistant United States Attorney

By:
Saundra J. Adkins
Special Department of Justice Attorney

By:
Eugene B. Paulisch
Special Department of Justice Attorney

EXHIBIT M

DECEMBER 3, 1979 -- MEMO FROM LINDA PENCE ON NAVY RECRUITING CLAIM

UNITED STAT GOVERNMENT

Memorandum

TO : File

DATE: DEC - 3 1979

FROM : Linda L. Pence
Attorney, Fraud Section
Criminal Division

SUBJECT: Navy Recruiting - Newport News Shipbuilding Co. Investigation

As part of its claim NNS requested from the Navy 24 million dollars in reimbursement which the company allegedly sustained as a result of an intensive recruiting effort by the Navy which robbed the company of many of its very skilled employees. The company divided the 24 million dollars of claims equally between all fourteen ships, thus, requesting 1.7 million dollars per ship reimbursement as a result of Navy recruiting.

Attached are the following company documents in support of the company's claim:

Exhibit A:	the methodology used in calculating the claim, i.e. the cost of having to recruit and train replacements.
Exhibit B:	the actual cost estimate filed with the claims which follows the same methodology.

Government's Investigation

As part of the investigation, the following people were interviewed and/or brought before the grand jury to testify regarding this item:

[redacted]

[redacted]

[redacted]

GRAND JURY MATERIAL
DO NOT DISCLOSE

EXHIBIT
2

Buy U.S. Savings Bonds Regularly on the Payroll Savings Plan

NNS-47

The Company's Cost Estimate Methodology

[redacted]

[redacted]

Discussion

The investigation has indicated that NNS claimed an amount for navy recruiting which personally believe can only be categorized as outrageous. By using the company's own methodology, you can calculate the total estimated incurred costs for recruiting and training allegedly sustained by the company for the entire 10,493 employees leaving the shipyard during this period. That amount of estimated incurred costs for the replacements of the 10,493 employees is over 1/3 billion dollars - an amount equal to 55.6% of Newports News direct and indirect labor costs for its entire 24,000 plus labor force. See Exhibits F, G and H.

Why, then, did NNS come up with such an off-the-wall figure if they properly estimated a cost figure close to actual costs associated with training a person with no or little experience. The amount is developed from Ashburn's failure to take into account several important factors in the development of his methodology:

1. While many employees leaving NNS may have had several years experience, most did not. The costs to replace a semi-skilled worker with one to two years experience is negligible.

2. Newport News does not have to train employees from scratch. Many employees who are hired are already skilled; many have worked for NNS before and are "re-hires". For example in 1973 NNS rehired 38.6% of its lossed skilled employees and 45.7% in 1974. See Exhibits I and J.

3. The estimates of the number of employees leaving to work for the Navy is taken from the total number of voluntary terminations of employees from the shipyard from January 1974 to October 1974. This number includes all employees, from summer help to janitors to secretaries. These persons do not require thousands of dollars to train.

Additional items which the company employees never bothered to take into account are as follows:

1. The Navy also loses skilled employees to NNS. Historically, employees are hired back and forth between the company and the Navy.

2. Historically, the company has lost employees to the Navy. No factor was taken into account to reflect this historical loss. (We thought this was important since a claim allegedly is for costs incurred by the contractors over and above what was anticipated by the contractor. However, no deduction was made for historical loss.)

While the claim seems outrageous to me, unfortunately, I do not believe the evidence developed to date standing alone supports a criminal indictment. We are sorely lacking evidence indicating criminal intent -- knowledge that the claim had no basis and that it was wrong for the company to submit it to the Navy.

[redacted]

[redacted]

[redacted]

[redacted]

The most we can prove its that we think the figure looks so large that the employees just had to know it was false. This is far short from demonstrating that they knew it was false and that they knew it was wrong to submit it to the Navy for claim reimbursement.

Defenses

Assuming we could show intent, the company still has raised some interesting defenses.

With respect to their failure to take into account their historical loss to the Navy or the number of employees hired and rehired, [redacted]

This is the general defense raised throughout the case -- that it doesn't matter whether the company actually expended the money it alleges it lost. For some reason it did not sustain the entire loss is by its own good deeds -- an underrun in the contract price because of efficiency or hires and rehires because of their excellent recruiting and training program.

ESTIMATE OF RETRAINING COSTS DUE TO NAVY RECRUITING PROGRAM FROM 1-1-73 TO 7-19-74

11-20-74

1. 9180 = Quits from 1-1-73 to 7-19-74
2. 9180 x 60% = 5508 Exit Interviews
3. 9180 x 40% - 3672 Not Interviewed
4. 75% of persons interviewed will state future intentions
5. 347 = Total who stated Gov't to be future employer
6. 234 or 67.4% of total were Craftsmen (PSA)
7. 113 or 32.6% of total were Designers or Salaried
8. 5508 x 75% - 4131 stated future intentions (total)
9. 4131 x 67.4% = 2784 stated future intentions (PSA)
10. 4131 x 32.6% - 1347 stated future intentions (D or S)
11. 5508 x 25% = 1377 Interviewed - Did not state intentions (Total)
12. 1377 x 67.4% = 928 Interviewed - Did not state intentions (PSA)
13. 1377 x 32.6% = 449 Interviewed - Did not state intentions (D or S)
14. 347 ÷ 4131 = 8.39% Quits going to Gov't of those given exit interviews
15. 3672 x 8.39% = 308 est quits going to Gov't of those not interviewed
16. 1377 x 8.39% = 115 est quits going to Gov't of those given interviews but not stating intentions
17. 347 + 308 + 115 = 770 est total quits to have gone to work for Gov't
18. 9180 x 8.39% = 770 (Check) est total quits to have gone to work for Gov't
19. 770 x 67.4% = 519 est quits to have gone to work for Gov't from (PSA)
20. 770 x 32.6% = 251 est quits to have gone to work for Gov't from (D or $\overset{S}{D}$)

A

21. $24000 Cost to retrain 1 man (PSA)
22. $31000 Cost to retrain 1 man (D or S)
23. 24000x 519 = $12,456,000
24. 31000x 251 = $ 7,781,000
25. 55.22 = est. avg. cost of recruiting one man
26. 55.22 x 770 = $42,500 est. cost of recruiting
27. 3% of Shipyard personnel (based on 10% sample) est. to have more than one skill; i.e., to replace would mean retraining in 2 or more skills.
28. 770 x 3% = 23 men
29. 23 x 24000 = $552,000 (assuming this only applies to craftsmen and each man has only one additional skill)
30. 12,456,000 + 7,781,000 + 552,000 + 42,500 = $20,831,500 Total Cost of Replacing Lost Employees

ITEM		Init	MATERIAL	PROD MANHOURS	SUPV MANHOURS	G & S MANHOURS
From January 1, 1973 through October 31, 1974, 342 N.N. employees* left the Contractor to work for the U.S. Navy. The projected number of N.N. employees leaving the Contractor to work for the Navy is estimated:						
Total Quits	10,493		1¾ yr.	= 1/10	93	
Total Stating Future Intentions	4,722					
Total to Navy	342					
342/4,722 = X/10,493 X = 760 (Projected Number of N.N. Employees Going to Navy)				Total	for	11/73 - 4/1/78
To reproduce equivalent lost skills, it is estimated that 10% more people must be hired and trained: Total = 760 x 1.1 = 836				Figure		
Estimated 69% (PSA) 31% (Salaried or Design)**						
69% x 836 = 577 (PSA Employees) 31% x 836 = 259 (S or D Employees)						
It is estimated 3% of N.N. employees (PSA) have more than one skill. To replace would require re-training in two or more skills.						
577 x 3% = 17 Employees Requiring Re-Training				10,493		
SUMMARY:		Costs				
Recruiting: 577 (PSA)	(Est)	63/ea.	36351			
259 (Salaried or Design)		630/ea	163170			
Training: 577 (PSA + 17 PSA Re-Trained) = 594		25,000	14850000			
259 (Salaried or Design)		35,000	9065000			
	TOTAL		24114521			
Applied Equally to 14 Ships Under Contract with Navy (24,114,521 ÷ 14)			1722466			
	Say		$1,700,000			

REMARKS

*Derived from Exit Interviews

**Based on Actual Figures: 236 ÷ 342 = 69% / 106 ÷ 342 = 31%

J.D.P.

W.T.C.

COMPUTED BY Aime 7/7/75

CHECKED BY [illegible] 7/11/75

AUG 5 1975

APPROVED BY [illegible] 1976

IX-581

November 21, 1974

J. R. Ashburn, Jr.

Attached is completed copy of Study on Training
t.

John M. Pirkle

88A

C

TRAINING AND DEVELOPMENT COST FOR MANY TRADE CLASSIFICATIONS AT NEWPORT NEWS SHIPBUILDING - A STUDY

November 20, 1974

PURPOSE:

To determine the cost of training associated with replacing skilled and semi-skilled personnel who have left the employment roll at Newport News Shipbuilding.

METHODOLOGY:

1. Divide trade classifications into four (4) parts, each part containing classifications with some common element, such as nature of work, wage structure, or organizational nature.

2. Make certain logical assumptions related to each of these four (4) parts.

3. Determine the training cost associated with the trades personnel development based on the stated assumptions and know pay rates and cost.

4. Shown actual calculations where necessary and sample calculations where appropriate.

5. Summarized each part and drawn conclusions as to cost based on calculations.

6. Presented total summary of study for quick recovery of final conclusions.

TOTAL SUMMARY:

PART I:

Waterfront crafts considered in the aggregate.

Accumulative cost by job classification to train any/all crafts

3rd Class Helper	$3,292				
2nd Class Helper	3,292	+	2281	=	$5,573
1st Class Helper	5,573	+	2116	=	7,689
3rd Class Handyman	7,689	+	3570	=	11,259
2nd Class Handyman	11,259	+	3185	=	14,444
1st Class Handyman	14,444	+	2861	=	17,305
3rd Class Mechanic	17,305	+	5012	=	22,317
2nd Class Mechanic	22,317	+	4314	=	26,631
1st Class Mechanic	26,631	+	4607	=	31,238
3rd Class Specialist	31,238	+	5560	=	36,798
2nd Class Specialist	36,798	+	4734	=	41,532
1st Class Specialist	41,532	+	4851	=	46,383/Man

PART II:

Occupations with limited application and personnel in training programs. (Radiogrophic Operators, MT/PT Inspector, Tool Clerk, Guard, Reproduction Clerk, Drawing Clerk, Welding Student, Burning Student, T/W Trainee, and Apprentice).

Cumulative cost for classification in Part II (except for Apprentices), is approximately - $3,879.00/Man.

Total cost per Apprentice = $15,420 + 6,000 = $21,420.00.

Cost per each of 8 6-month apprentice terms = $2,678.00/Man

PART III:

Salaried Occupations (Engineer thru Estimator)

Associate Engineer level personnel, training cost	= $24,420/Man
General classification of Engineer, training cost	= $35,520/Man
Foreman, General Foreman and Apprentice Instructor, training cost . .	= $43,620/Man
Shift Test Engineer, training cost	= $49,395/Man

PART IV - Design Occupations (Technical Aide thru Senior Designer

Design or Technical Aide training cost = $ 3,550/Yr

Junior Designer training cost = $21,299.00 initially, plus $5,325.00 per each year in this classification.

Designer training cost, $21,299 + 21,934 = $43,233.00 initially, plus $6,782.00 per each year in this classification.

Senior Designer training cost $43,233 + 27,128 = $70,361.00 initially, plus $8,658 per each year in this classification.

NOTES: 1. Occupations considered are those listed on "Newport News Shipbuilding Personnel Terminating to Work for Norfolk Naval Shipyard (Jan.-73 - July 19, 74)"

2. Time required to accomplish this training is as follows:

a. Part I - from 3 months to 4 years, 9 months. See Assumption 3. page 1.

b. Part II - 8 weeks except for Apprentices who require four (4) years.

c. Part III - Two to three years. See Assumption pages 5 and 6.

d. Part IV - Four to six years. See Assumption page 7.

3. Following pages are detail support material.

TRAINING COST PER JOB CLASSIFICATION AT NEWPORT NEWS SHIPBUILDING

PART I.

SCOPE: Calculated cost of training necessary to develop unskilled manpower for most of the skilled job classifications at Newport News Shipbuilding.

ASSUMPTIONS:

1. Start with new hires at or near zero level of skill.

2. a. Requires approximately nine (9) months to go from 3rd Class Helper to 3rd Class Handyman.

b. An additional twelve (12) months to reach 1st Class Handyman.

c. An additional eighteen (18) months to reach 1st Mechanic.

d. An additional eighteen (18) months to reach 1st Class Specialist.

3. Assume effective production as follows:

Helper Classification		Handyman Classification	
1st 3 Months	30%	1st 4 Months	50%
2nd "	60%	2nd "	60%
3rd "	80%	3rd "	70%

Mechanic Classification		Specialist Classificati	
1st 6 Months	60%	1st 6 Months	60%
2nd "	70%	2nd "	70%
3rd "	70%	3rd "	70%

4. Use an overhead rate 85% across the Waterfront Trades applied to base rate to obtain effective pay rates as shown below.

HELPER			HANDYMAN			MECHANIC			SPECIALIST	
3rd	2nd	1st	3rd	2nd	1st	3rd	2nd	1st	3rd	2nd
6.36	6.70	7.00	7.30	7.71	8.08	8.45	8.94	9.50	9.82	10.34

5. Personnel in training (O.J.T.) will require more supervision than experienced manpower. Therefore, for each ten (10) inexperienced assume need for an additional supervisor for approxima 2 years.

Assume average base rate of \$8.50/hr. x 1.85% = \$15.70/hr/supervisor.

For 2 years $\frac{\text{4160 hrs X \$15.70/hr}}{\text{10 men}}$ = \$6,531 additional cost per man.

For 3 Mos: (1/8 x 6531) = 816 additional supervisary cost per man

For 4 Mos: (1/6 x 6531) = 1,088 " " "

For 6 Mos: (1/4 x 6531) = 1,632 " " "

6. Classroom work requires an instructor. Assume for each week of classroom (mock-up) training required one instructor per five (5) trainees.

$\frac{\text{\$15.70/hr x 40 hrs}}{\text{5 men}}$ = 125 Cost per man/week

CALCULATIONS:

1. To determine the effective labor rates:

Existing base rate + 85% overhead rate = effective rate

Examples: 3rd Class Helper @ \$3.44 base rate

\$3.44 x 1.85 = \$6.36 effective rate

1st Class Specialist @ \$5.80 base rate

\$5.80 x 1.85 = \$10.73 effective rate

2. To determine effective training cost by classification:

Effective rate x hours per period x ineffective percentage.

Examples: 3rd Class Helper for 3 months.

\$6.35/hr x 500 hrs x 70% = 2,222 Training Cost

2nd Class Handyman for 4 months

\$7,71/hr x 680 hrs x 40% = 2,097 Training Cost

1st Class Mechanic for 6 months

\$950/hr x 1000 hrs. x 30% = 2,850 Training Cost

Summary of cost by job classification:

HELPER	Effective Labor	Supervision	Instructor	Total
3rd Class	2,226	816	250	3,292
2nd Class	1,340	816	125	2,281
1st Class	1,050	816	250	2,116
HANDYMAN				
3rd Class	2,482	1,088	-	3,570
2nd Class	2,097	1,088	-	3,185
1st Class	1,648	1,088	125	2,861
MECHANIC				
3rd Class	3,380	1,632	-	5,012
2nd Class	2,682	1,632	-	4,314
1st Class	2,850	1,632	125	4,607
SPECIALIST				
3rd Class	3,928	1,632		5,560
2nd Class	3,102	1,632	-	4,734
1st Class	3,219	1,632	-	4,851
			TOTAL	46,383

CONCLUSIONS:

Accumulative cost by job classification to train:

3rd Class Helper	$3,292				
2nd Class Helper	3,292	+	2281	=	$5,573
1st Class Helper	5,573	+	2116	=	7,689
3rd Class Handyman	7,689	+	3570	=	11,259
2nd Class Handyman	11,259	+	3185	=	14,444
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3rd Class Specialist	31,238	+	5560	=	36,798
2nd Class Specialist	36,798	+	4734	=	41,532
1st Class Specialist	41,532	+	4851	=	46,383/Man

PART II

SCOPE: Calculated cost of training for occupations with limited application and Training Programs.

ASSUMPTIONS:

1. Start with new hires at or near zero level of specific skills, who are prepared to learn these skills.
2. Except for an Apprentice* all these skills should be learned sufficiently to become somewhat productive within an eight (8) week period devoted to training.
3. After the initial eight (8) week training period the individual will be 70% effective on-the-job for the following six (6) months after which he is proficient.
4. Use the same rates as for Helpers in Part I.
5. For eight (8) weeks training period one instructor-foreman is required for each six (6) trainees. Following the initial training period no additional supervisors are assumed.

CALCULATION:

Labor Cost: $6.36/hr x 40 hrs x 8 weeks = $2,035.00/Man
6.70/hr x 500hrs x 30% = 1,005.00/Man

Total Labor Cost $3,040.00/Man

Supervisor/Instructor Cost:
$\frac{\$15.70/\text{Hr} \times 320 \text{ hrs}}{6}$ = $ 838.00/Man

Total Training Cost per man in Part II excluding Apprentices. = $3,878.00/Man

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*Apprentices can be assumed to be about 75% effective over the total training period because of the close supervision given them.

Cost per Apprentice:

Administrative cost per apprentice including non-productive supervisory cost - approximately $1,500.00/Yr.

Using average overall rate for 4 years of $7.71/Hr. labor cost for one apprentice:

- $7.71/Hr x 8000/Hrs. x 25% effective = $15,420.00

CONCLUSIONS:

Cummulative cost for classification in Part II (except for Apprentices is approximately $3,878.00/Man.

Total cost per apprentice = $15,420 + 6,000 = $21,420.00

Cost per each of 8 - 6-month terms = $2,678.00/Man

PART III.

SCOPE: Cost associated with the development of salaried personnel to include all engineers and related occupations.

ASSUMPTIONS:

1. These individuals will have to come into the Company as new hires with the appropriate academic background.

2. New hire associate engineer will follow the following curve of effectiveness:

1st 4 Months	30%	4th 4 Months	60%
2nd "	40%	5th "	70%
3rd "	50%	6th "	80%

So that over the first two (2) year period he is about 50% effective, after which his performance is normal.

3. Upon promotion to engineer (of any speciality) his 1st year's performance effectiveness is about 60%.

4. Q.I.D. Inspectors, Expediters, Estimators, Programmers, Illustrators, are about as costly to develop as Associate Engineers.

5. Foreman, General Foreman, Apprentice Instructors, must be developed from within the Company and requires 2 years at 60% effectiveness.

6. Extra supervision cost is included in lost effectiveness.

CALCULATIONS:

1. Associate Engineer level personnel,
Monthly base rate x 1.85% overhead x 24 mos. x 50% Ef

1100 x 1.85 x 24 x .50 = $24,420.00/Man

2. Engineer (all types except shift Test Engineer) level
Assoc. Engr. Cost + Mo. Base Rate x 1.85% overhead x 12 Months x 40% Effectiveness.

24,420 + (1250 x 1.85 x 12 x .40) = 24,420 + 11,100 =
$35,520.00/Man

3. Shift Test Engineer receives 6 months full time training. Engr Cost + Mo. Base Rate x 1.85% o/h x 6 Mos.

35,520 + (1250 x 1.85 x 6) = 35,520 + 13,875 = $49,39

4. Foreman, General Foreman, Apprentice Instructor level
Total cost of one Apprentice training + Mo. Base Rate x 1.85 x 24 Mos. x 40% effectiveness.

21,420 + (1050 x 1.85 x 24 x .40) = 21,420 + 22,200 =
$43,620.00/Man

CONCLUSIONS:

Associate Engineer level personnel training cost = $24,42

General classification of Engineer training cost = $35,52

Foreman, General Foreman and Apprentice Instructor training cost . . . . = $43,62

Shift Test Engineer training cost . . . . . = $49,39

PART IV

SCOPE: Cost associated with developing technical aides throug Senior Designers.

ASSUMPTIONS:

1. Start with an individual employed as a technical aide or design aide and over time develop an individual to Senior Designer.

2. Individuals progress along the following curve of effectiveness:

   Design or Technical Aide 70% effective over 6 year period, average base rate - $123.00 Weekly.

   Junior Designer 70% effective over 4 year period, average base rate - - - $190.00 Weekly.

   Designer 70% effective over 4 year period, average base rate - - - - - $235.00 Weekly.

   Senior Designer 70% effective over 5 year period, average base rate - - $300.00 Weekly.

3. No additional supervision is needed if number of new hires is small and brought in on a regular basis.

CALCULATIONS:

1. Design or Technical Aide:

   Average Base Rate x 1.85% overhead x 52 Wk x 6 Yr x 30% effective

   $123 Wk x 1.85 x 52 x 6 x .30 - $21,299.00/

2. Junior Designer:

   $190 Wk x 1.85 x 52 x 4 x .30 - $21,934.00/

3. Designer:

   $235 Wk x 1.85 x 52 x 4 x .30 - $27,128.00/

4. Senior Designer:

   $300 Wk x 1.85 x 52 x 5 x .30 - $43,290.00/

CONCLUSION:

Design or Technical Aide training cost - $ 3,550/Yr

Junior Designer training cost - $21,299.00 initially, plu
$5,325.00 per each year in this classification

Designer training cost, $21,299 + 21,934 = $43,233.00 initially, plus $6,782.00 per each year in this classification.

Senior Designer training cost $43,233 + 27,128. = $70,361.0 initially, plus $8,658 per each year in this classification.

INTER-OFFICE COMMUNICATION

NEWPORT NEWS SHIPBUILDING AND DRY DOCK COMPANY

TO: Mr. J[illegible] A[illegible]

FILE NO.

FOR: Information

DATE: May [illegible] 1975

FROM: Manager of Apprentice Training

SUBJECT: Cost of Training a 5-year Apprentice Designer

In response to your telephone request on May 9, 1975 at 1:40 P.M., regarding the cost of training a 5-year Apprentice Designer, I quoted $30,000.00 at 2:00 P.M. Due to the limited time available (20 minutes), only the simplest assumptions and calculations could be made to support this quote. However, I feel it is reasonable.

E. A. Urick

EAU:mjt

Ⓓ

DEPARTMENT OF THE NAVY
NORFOLK NAVAL SHIPYARD
PORTSMOUTH VIRGINIA 23709

NY6/12410(180)abr

22 FEB 1979

Naval Investigative Service
Box 72
Naval Weapons Station
Yorktown, Virginia 23791
Attn: Mr. Sotack

Dear Mr. Sotack:

During our conversation of 8 February 1979, you requested this activity provide information concerning the cost of training an apprentice by trade. As I indicated, our charges are reported by total hours of training and not the hours of training within specific trade areas, e.g., machinist or electrician. Since the majority of our shops have apprentices in more than one trade the costs of training graduates in the individual programs cannot be determined from the data available.

We can however, determine the cost of training the average apprentice as $25,373.20 over a four year period. This total includes a 30% acceleration factor to cover employee fringe benefits, a $6.17 per hour general expense charge, the costs of the apprentice school staff, and charges for contract services provided by Tidewater Community College. It is the result of dividing the total apprentice expenditures as reported to the Comptroller Department for FY 78 by an average apprentice class for that year of 1,051. This one year total was then projected for three additional years to arrive at the average cost per apprentice graduate.

I trust that this information will meet your needs. Should you have any additional questions concerning these charges, feel free to contact me on 393-7318.

Sincerely,

M. F. Kimball

M. F. Kimball, Head
Employee Development Division

. 10,493 QUITS

. 10% MORE MUST BE HIRED
10,493 x 1.1 = 11,542

3. 69% (PSA) 31% (SAL + DESIGN)
PSA = 69% x 11,542 = 7,964
SAL + DESIGN = 31% x 11,542 = 3,578

. 3% MORE THAN ON SKILL : 7,964 x 3% = 239

5. SUMMARY :

RECRUITING
7964 (PSA) x $63 501,732
3578 (S+D) x $630 2,254,140
7964+239 x $25,000 205,075,000
3578 x $35,000 125,230,000
$ 333,060,872

F

[illegible] AND RECRUITING COSTS TO NNS TOTAL ACTUAL LABOR COSTS

A. Estimated Recruiting and Training

Total Estimated Recruiting and Training Costs for January 1, 1973 - October 31, 1974 per [illegible] methodology in claim $333,060,072

B. NNS Actual Costs

(Total Labor Plus Overhead Costs for Entire Company)

NNS Actual Costs for 1973

Direct Labor	$171,649,000		
Overhead	$151,115,000		
		Total for 1973	$332,764,000

NNS Actual Costs for January 1, 197 to October 31, 1974

Direct Labor	$148,853,000		
Overhead	$124,805,000		
		Total for Oct., 1974	$273,658,000

NNS Total Actual Costs from January 1, 1973 to October, 31, 1974

$606,422,000

C. Comparison of A to B

Percentage of Total Estimated Recruiting and Training Costs to Total Actual Costs from Jan. 1, 1973 to Oct. 31, 1974 55.8%

Source: Newport News Management Information Report; Direct Labor & Overhead, July - December, 1974.

DIRECT LABOR AND OVERHEAD

Reflecting Contribution of Major Overhead Categories to the Total Overhead Rate
(Amounts in thousands)

MONTH	ACTUAL COSTS		OVERHEAD AS A % OF DIRECT LABOR	OVERHEAD PERCENT CONSISTED OF						
	DIRECT LABOR	OVERHEAD		INDIRECT LABOR	PERSONNEL RELATED COSTS	FIXED CHARGES	REPAIRS, MAINT. MATERIAL	ACQUISITION OF TOOLS	MISC. MAT'L.	OTHER ACCTS.
1972										
JAN	$ 12,603	$ 10,038	79.6	45.7	14.9	4.8	1.9	1.4	8.4	2.5
FEB	12,724	10,534	82.8	45.5	17.2	4.9	3.4	1.6	9.7	0.5
MAR	16,037	12,540	78.2	43.7	16.2	4.9	2.6	1.9	7.9	1.0
APR	12,381	10,406	84.0	46.6	17.8	5.1	3.2	1.9	8.7	0.7
MAY	12,795	10,614	83.0	46.0	16.8	4.9	3.2	1.4	9.7	1.0
JUN	15,116	13,111	86.7	47.5	17.6	5.2	3.3	1.8	9.8	1.5
JUL	11,799	10,423	88.3	50.8	16.2	5.3	3.2	1.7	9.3	1.8
AUG	12,752	11,289	88.5	52.0	16.0	5.0	3.2	1.4	10.2	0.7
SEP	15,704	13,508	86.0	51.3	14.6	5.0	2.9	1.5	8.9	1.8
OCT	13,596	11,716	86.2	49.5	13.5	4.7	3.4	2.1	9.2	3.8
NOV	12,543	11,369	90.6	51.7	13.5	5.2	3.0	1.6	12.8	2.8
DEC	14,161	14,636	103.4	55.0	14.9	5.9	3.9	1.9	12.9	8.9
YR END ADJ		3,360								
TOTAL	$162,211	$143,752	88.6	48.6	15.4	5.0	3.1	1.7	12.4	2.4
1973										
JAN	$ 12,150	$ 12,104	100.2	55.4	18.3	5.0	3.0	1.1	13.9	2.7
FEB	13,547	12,953	95.6	51.7	19.1	5.2	3.0	1.5	12.6	2.5
MAR	17,414	15,847	91.0	49.4	18.7	5.1	2.6	1.5	11.3	2.4
APR	13,009	12,460	95.8	50.7	21.1	5.6	3.6	1.7	12.6	0.5
MAY	13,961	12,246	87.7	44.5	19.9	5.0	3.5	1.6	11.2	2.0
JUN	16,243	13,587	83.6	44.4	17.9	5.5	3.1	1.7	10.7	0.3
JUL	12,832	11,408	88.9	45.3	21.0	5.5	4.1	.1	10.5	2.4
AUG	13,856	11,770	84.9	42.2	19.1	5.0	3.1	.2	12.6	2.7
SEP	16,844	12,554	74.5	41.9	16.6	5.2	2.5	.0	8.8	(1.3)
OCT	14,243	10,767	75.6	40.3	19.0	4.9	2.4	.4	10.3	(1.7)
NOV	13,165	10,497	79.7	42.2	17.7	5.3	2.5	1.0	11.3	(.3)
DEC	14,377	13,278	92.4	45.7	18.7	6.2	2.4	.6	10.8	8.0
YR END ADJ		1,564								
TOTAL	$171,649	$151,115	88.0	46.5	19.0	5.4	2.7	1.2	11.4	1.8
1974										
JAN	$ 12,560	$ 11,516	91.7	48.8	20.5	6.2	2.0	.5	14.2	(0.5)
FEB	14,051	12,334	87.8	44.6	21.8	5.1	2.3	.6	11.9	1.5
MAR	17,333	14,527	83.8	45.1	19.0	5.3	2.0	.8	11.0	.6
APR	12,919	12,273	95.0	46.2	23.1	5.8	2.8	.3	15.8	1.0
MAY	13,699	11,864	86.6	44.3	21.3	5.5	2.6	.7	12.4	(.2)
JUN.	16,383	13,471	82.2	43.3	18.4	5.5	3.0	.6	11.1	.3
JUL	13,574	11,122	81.9	39.4	21.1	5.2	2.8	.7	12.4	.3
AUG	14,445	11,564	80.1	41.3	19.7	4.9	2.3	.6	11.7	(.4)
SEP	18,562	14,235	76.7	40.2	17.1	4.9	2.7	.5	11.5	(.2)
OCT	15,328	11,899	77.6	40.2	18.2	4.7	1.9	.6	12.1	(.1)
NOV	15,662	12,173	77.7	39.5	17.5	4.7	2.3	.6	13.8	(.7)
DEC	14,180	12,468	87.9	43.8	19.8	6.6	2.5	.7	13.7	.8
YR END ADJ		(1,553)								
TOTAL	$178,703	$147,893	82.8	42.3	19.4	5.3	2.5	.6	12.5	.2

DEFINITIONS:

OVERHEAD RATE: ratio of indirect l
and material costs to straight di
labor dollars

INDIRECT LABOR: supervisory, clerl
miscellaneous and other labor not
chargeable to a specific cont
repair, maintenance and prod
labor; sick leave, allowed tim
accrued vacation and accrued holid

PERSONNEL RELATED COSTS: workmen's
compensation, FICA, unemployment
compensation, pension fund contril
tion, disability payments, group
insurance, thrift plan and severar
pay

FIXED CHARGES: depreciation, insur
and plant related taxes

REPAIRS AND MAINTENANCE (MATERIAL
material for maintenance and repa
buildings, machinery and tools, a
test equipment calibration

ACQUISITION OF TOOLS: purchased o
manufactured consumable tools

MISCELLANEOUS MATERIAL CHARGES: f
supplies, contributions and dues,
rentals, legal and accounting fee
travel and entertainment, interco
fees and other miscellaneous cost.

OTHER OVERHEAD ACCOUNTS: product
expense (material), state income
state use tax, discounts on purch
profit on independent operations
inventory/accounting adjustments

JAN. 1 TO OCT. 31 1974

		HIRES			
	QUITS	NEW	RE-HIRES	TOTAL HIRES	% T.H. / Q
KILLED	542	55	186	241	[illegible]
PECIALISTS	25	0	3	3	12.
ANDYMEN	646	233	188	421	65.
ELPERS	1777	3942	459	4401	247.
ABORERS	6	14	2	16	[illegible]
ODE 5	166	103	84	187	112.
PPRENTICE	128	174	6	180	140.
ECHNICAL	420	96	31	127	30.2
LERICAL	118	62	11	73	61.8
+-M WEEKLY	46	1	4	5	10.8
ALARIED	678	331	44	375	55.3
OTALS	4552	5011	1018	6029	132.

	QUITS	HIRES NEW	 RE-HIRES	 TOTAL HIRES	% 7-11 9
KILLED	657	90	164	254	35 38.0
PECIALISTS	7	0	1	1	14.2
ANDYMEN	807	320	201	521	64.5
ELPERS	2377	4988	828	5816	244.6
ABORERS	15	29	2	31	20.1
ODE 5	163	97	79	176	107.9
PPRENTICE	114	140	5	145	127
ECHNICAL	521	104	22	126	24.1
LERICAL	268	132	32	164	61.1
H-M WEEKLY	28	3	3	6	21.4
ALARIED	984	380	94	474	48.1
OTALS	5941	6283	1431	7714	1299

EXHIBIT N

MARCH 1980 -- PAULISCH "BOW DOME" MEMO

(V) Paulisch comments on "Bow Dome" pros memo.

Ex 120

The prosecution report on the "Bow Dome" ~~stern~~ item of the 688 class submarine claim~~s~~, discusses both the individual hardware item s and, in addition, addresses all of the five claims put together by NNS during a 30 month period from late 1973 thru 1975 and concludes that ~~the~~ No prosecution should be attempted. The conclusion is based largely on the presentation of the claims as having been written from the "bottom up", rather than having been put together to achieve a pre-determined price goal, and thus having a certain "integrity" overall which, it is concluded, will bring on a defense which stresses the "peanuts" characterization of the one or two small hardware items in comparison to the overall integrity of the $800 million total of the combined claims.

While there are various specific conclusions with respect to the "Bow Dome" item which may be questioned, the ~~primary~~ primary comment here are directed to the "broad considerations" going to a prosecution decision, since if the broad consideration, i.e., overall integrity of claim writing process, no evidence of a pattern of misstatements in hardware items, failure of proof of ficticious Manhour and material costs, etc., are subject to serious question, the conclusion with resp-ct to the various individual hardware items may be justified.

The Pattern of NNS Claims

The "Bow Dome" memo (p. 27) discusses at some length the fact that there is no displayed pattern of deliberate misstatements in the various hardware items investigated in the 688 class claim. Whether such a pattern can be displayed in the hardware items is not in itself significant. In the 688 class claim, hardware items accounted for only $29 million of the $200.1 million Target Cost adjustment claimed. Of that $29 million claimed, the Navy analysis concluded that there was $2.8 million of entitlement. Whether or not there is a pattern of deliberate misstatements in these hardware items is one issue. It appears obvious that there is a PATTERN OF claiming contract price adjustments to which the contractor was not entitled.

All five of the NNS claims investigated (CGN 36-37, SSN686/87, SSN688, CGN 38-40, and CVN 69-70), totaling some $800 million in ceiling price adjustments, display the same situation as the 688 class claim. In all cases the hardware items taken together were "peanuts" compared to the total claim. In all cases the so-called "soft" items accounted for 80 to 90 per cent of the claim.

The pattern displayed by the NNS claims is apparent. The NNS claim preparation group was designed so that many documents appear in the working files showing that the claims were written from the "bottom up". Waterfront people were solicited by the claim group for items which were considered to have contributed to cost overruns. More specifically, the investigative staff has these memoranda in hand, which solicit from the waterfront instances where "the 'as built' condition differs from the basic contract requirements". In each claim, a number of such items were received from the waterfront, and incorporated into a claim outline by the various claim group supervisors. It is noted that the waterfront people were not asked for any approximation of cost, if any. From the claim writer's write up of the item suggested by waterfront, a group of cost estimators assigned to claims then estimated the cost.

While it may be argued that there is no pattern of deliberate misstatements in the suggestions received from the waterfront by the claims group, we think that the handling of these solicited suggestions by the claim group does display a pattern. First, the write.ups were done without regard to whether or not the AS BUILT condition varied from the original contract requirements did in fact result in actual added cost. Both Adams, manager of cost estimating, and Willis are on record subscribing to this theory of pricing claims at an "estimated market value" rather than actual cost. Adams so testified to the grand jury. Willis hnadwritten memo to Pittard regarding claim pricing, which we have in files, directs Pittard to price the claims in this fashion. This is the same basic theory of claim pricing advanced by Dart in his testimony, and in his statements to RADM Manga~~d~~aro dur~~r~~ing settlement negotiations (see pros memo, p. 34, #3)

Second, all items in all the claims show a consistent pattern of over-reaching ~~by~~ in the cost estimating, beyond the pricing of the theoretical "estimated market value" noted above. In the items "Main Seawater Valves", "Forward Platforms", "Bow Dome", in 688 class claim, for example, we took time to question cost estimators about their estimating calculations and found that the estimators had "fooled around" with their estimating calculations until they had covered all possible actual cost plus a substantial surplus of claimed cost. The work papers of F.L. Johnson, cost estimator, clearly show how Johnson worked up every possible actual cost that NNS could be expected to incurr (even factoring in the company's own declining labor productivity factor) on the main sea-water valves, which he labeled "Claim target". After a series of calculations, each of which came up with a higher number, Johnson submitted an estimate which claimed 10,000 more labor hours than the company actually booked on the whole job. Collin's estimating on "Navy Recruiting" shows the same disregard for actual cost, [redacted] finally a little "rounding off" of numbers that served to raise the claimed cost by a substantial amount. A number of items in the CVN claim, (MUDPS, Discrepancy Reports, etc.) all display a pattern of grossly exaggerated estimating by using questionable sampling techniques to project total claim costs.

Concluding this point, it appears that a fair evaluation of the investigation results do not justify a conclusion that there is no pattern discernable in the hardware items. Whether this pattern of claiming a theoretical cost differential between the as built condition and original contract requirements at an "estimated market value", plus a substantial surplus, is a violation of law, is another issue and one that is really not necessary to resolve. The fact of that pattern is simply evidence.

The real pattern of the NNS claims, and the one which is proveable, and which we think is evidence of reckless disregard of the truth in the filing of these claims to the Government, is in the overall structure of all of the five claims viewed as one well coordinated and directed project.

The "Bow Dome" prosecution report makes as one of its major conclusions that since there was no specific documentary evidence, and no testimony provided by NNS witnesses, showing that NNS management directed lower level people to write the claims to a predetermined price objective, the claims were therefore written from the "bottom-up", letting the pricing fall where it may. This is said to display the integrity of the claims writing process. As pointed out above, this claims writing from the "bottom-up", concept is based, in the pros memo, on the fact that the individual hardware claim items were initiated by various waterfront people, who were solicited by the claim group for these suggestions. The previous discussion negates the "bottom-up" concept. These hardware items accounted for only about 20% of claim dollars, even as the re-worked and priced by the claim group. The evidence shows that the management of the claim group controlled the total value of the claims by designing the claim structure to include the dozens of relatively insignificant hardware items solicited from the shipyard, then adding to that structure all of the "soft" items, which account for some 80% of the total claimed. The value of these "soft" items, delay, disruption, deterioration of labor, acceleration, and financing may be easily adjusted by millions of dollars by making minor adjustments in the calculations. The theory of all the soft items came from the top according to the NNS claim people who were assigned to write up and estimate costs for these items. The NNS backup files contain dozens of draft claims, which outline the structure of the claims, by claim item. The testimony of the claim writers and estimators was consistent.

They were assigned items from the outlines and told to do write ups and estimates. Much of the questioning of NNS witnesses by the staff dealt with the various estimating calculationg, seeking an explanation from an estimator for a flaky looking calculation. The estimates responses were consistently that they were assigned the item, and given a narrative description of what they were supposed to price. The narrative description determined the pricing calculations. In the case of the large "soft" item claims, admittedly incorporated into the claims by the claim group management, the narrative description provided the base of the calculations. The estimator merely did his assigned job.

All five of the NNS claims are designed in basically the same way. Whoever controlled the "soft" items that went into the claims, and the narrative theory of the item, controlled such a significant portion of the total value that the hardware items became a miner consideration in determining the final dollar amount of the claim. The evidence shows that Willis and two or three of his supervisors in the claim group made the decisions as to the soft items. That group made the decision to claim all delay on all ships, even though they obviously knew, and in fact admitted in testimony, that there were delays for which NNS was responsible, and delay for which the Government had already paid for, or was otherwise not contractually liable for. The justification for claiming all such delay was that delay responsibility is very difficult to assess with any degree of precision, and that the relative responsibility was a matter for negotiation, along with the contract interpretation issues.

Whether the rationale for claiming all delay which occurred on these ships is arguably acceptable, the pricing of that delay displays a clear pattern, across all the claims, of gross exaggeration. Deterioration of Production Labor is claimed as an element of delay cost. Minor variations in the "rate of deterioration" may vary total amount claimed by millions of dollars. The estimated cost per day of delay displays gross exaggeration across all claims. Since all delay days are claimed, even a small exaggeration of estimating judgement as to cost per day results in millions of dollars of claimed costs. Disruption appears in all claims as a major "soft" item. The management decision to claim disruption on every labor hour, regardless of actual conditions existing in the shipyard, is responsible for millions of dollars claimed. The "rate of disruption" used in the pricing calculations are purely estimating judgements, and again a very small variation in the rate varies the total claimed by millions of dollars.

Again, whether the clear pattern of gross exaggeration displayed across all the claims in the "soft" cost items, all of which were admittedly designed into the claims by management, is sufficient in itself to base an indictment, is really not the question. That pattern is, like the pattern displayed in the Assembly and pricing of the hardware items, simply evidence that the NNS claims were put together from the "Top-down" - rather than being the result of a claim writing process which NNS perfers to desribe as a good faith effort by low level working people to assemble all the facts.

The key issue for decision in this investigation is whether, in the face of evidence that the NNS claim writing group was put together and given a pre-determined price objective by corporate management, Willis and/or Adams, acting individually or in concert, should be indicted for their reckless disregard of the truth in designing the claims and providing pricing calculations to accomplish the pricing objective.

It is a known fact, and specific testimony is available to establish the fact, that Diesel, then recently installed as President of NNS, told the Navy in November, 1974 that the five Navy contracts would have to be adjusted upward by $200 million dollars. At the time, very little claim work had been done, and no claim pricing figures were available to Diesel. By late 1974 the NNS claim writing effort had been reorganized into the large group headed by Willis, and the Asset value of claims against the Government was approaching $200 million on NNS Profit and Loss Statement and hence into the NNS Annual statements. By September of 1975 all the NNS claims had been assembled and priced: Claimed Target Cost Adjustment, $600 million, Claimed Contract Ceiling Adjustment, $800 million, asset value of claims on NNS P&L Statement, $200 million.

Mr. Diesel's opening to RADM Manganora, designated in June 1976 to evaluate and settle if possible the NNS claims, was that he wanted $200 million for these claims. That was the amount necessary to book as asset value of claims to keep NNS in the black from 1973 on. That was the amount he had booked, and that was the amount he was going to get.

A number of NNS employees interviewed in this investigation offered the same explanation as to why claims against the Navy had to be somewhat inflated by "estimating judgment". From Loredo, Diesel, Dart, through the lowest cost estimator, all said that NNS had traditionally settled claims with the Navy at about 45 cents on the dollar claimed. It appears that claims totaling about $440 million would have achieved that objective, rather then the $600+ million (Target cost) claims that were submitted. Diesel's statements explain the inconsistency. He had decided that $200 million in asset value must be booked to keep NNS in the black. He required the acceptance of that number by the company auditors (and the SEC) as a conservative assert value so that NNS Annual reports showed an operating profit. About 30% of gross claim value seemed to be conservative, especially in view of prior Navy claim experience. Claims with a gross value of about $650 million target and $800 million ceiling would accomplish two nice things.

(1) Asset value claims carried on the P&L would be a conservative 30%.

(2) The dollar asset value of a claim for about $650 million which is what I ~~and~~ told you in November 197

There is one other point made several times in the Bow Dome memo which deserves comment. It is noted, and correctly, that NNS did not misrepresent its anticipated total final cost of completing these ships. If the NNS representation, made many times in the course of this investigation, that the relative amounts claimed are really not claims against the Government at all, since NNS could not get more than its actual cost plus a reasonable profit in any event under the Incentive Share contracts for these ships, is correct, then perhaps the fact that NNS did not misrepresent its total cost to complete may be of some significance. The NNS version being played for the grand jury is not correct in the situation as it existed when NNS put these claims together. The facts establish that when NNS got into the claim effort in late 1973 and early 1974, all of the contracts overruns EXCEEDED TARGET, were in some cases were approaching or over the ceiling price.

The contracts which NNS signed with the Government were not cost plus reasonable profit contracts. The contracts are all firm fixed price incentive cost share contracts. ~~The firm fixed price incentive cost share contracts.~~ The firm fixed price is the Target cost number. The incentive is an agreed profit on that number, plus a 20% share of any under run of target cost. Over target cost, the Government pays 70% of the cost overrun, the contractor eats 30%, which simply serves to decrease the original contract profit amount. At the point where the Contractor has absorbed so much over-run that it no longer has any profit (called the Point of Total Absorption), contractor obviously is losing 30 cents on each $1.00 of cost over-run. This condition continues until the cost exceeds the contract ceiling price. At this point the Government stops paying any overrun and contractor looses $1.00 for each $1.00 spent.

In the contract pricing structure as described above, once the contract cost exceeds the contract target cost figure - which it had on all the NNS contracts - any dollar of incurred cost which is not 100% Government responsible, giving rise to a dollar for dollar adjustment of the contract target cost number, will cost the contractor 30 cents. Thus a contractor under a FFPI contract will never recovery all its costs - where any dollar of incurred cost over target is due to the contractor's inefficiency, mismanagement, ~~[illegible]~~ declining productivity, etc.

Thus the NNS position is not correct from the contract point of view unless the assumption is made that all incurred cost up to some adjusted target cost number are 100% Government responsible - in other words, that the claims for adjustment of target cost upwards to cover all incurred cost are correct.

~~Secondly, the NNS statement is incorrect and in fact a misrepresentation to the grand jury, because in the condition which existed on the NNS contracts at the time the claims were filed, NNS had no expectation of recovering all its costs even under its own expectation of target cost upwards to cover all incurred cost are correct.~~

Secondly, the NNS statement is incorrect and in fact a misrepresentation to the grand jury, because in the condition which existed on the NNS contracts at the time the claims were filed, NNS had no expectation of recovering all its costs even under its own expectations of target cost adjustment (the NNS discounted claim values), since in all cases even the NNS expectation was less than the actual incurred cost. Thus NNS could not expect to recover more than 70% of its cost over the (hopefully) adjusted target cost, plus a re-negotiated profit (not provided for in its contract) sufficient to cover the 30% NNS shore of cost over target and still leave some dollars which will show up ~~or~~ as profit on the Annual statement.

The Bow Dome memo, at page (2), para. (1) discusses the effect of submitting a claim for $567,000 for the Bow Dome. In the condition that the 688 contract was in at the time the claims were submitted, any upward adjustment of the contract target cost would pick up 100 cents of each $1.00 of incurred cost, plus some negotiated profit dollars.

It must be observed that the source of the contract target cost adjustment makes no difference to the final calculation. Whether the target cost is adjusted upward for a hardware item, a deterioration or disruption dollar, makes no difference to the relative profitability of the adjustment. In the final calculation of contract price, ~~and~~ an upward adjustment of target cost will serve to pick up 100 cents of each $1.00 of cost up to target, whether contractor responsible expense or Government responsible expense.

The objective of the NNS claims was not to misrepresent NNS expectation of the actual cost to complete these ships, nor could there have been any expectation of doing so. The incurred cost was continuously monitored by the Navy via DCAA. The objective of the NNS claims was to adjust the contract pricing structure to minimize the spread between contract target cost and incurred cost and to keep the Point of Total Absorption well above incurred cost. Because the contract (in the overrun condition in which NNS found itself) would pick up only 70% of cost, the NNS claims must necessarily be inflated by at least 45-50% of cost plus a "reasonable profit".

To keep the asset value of claims at a conservative 30% or so, in order to carry that asset value on the NNS public books for three years ~~s~~pending the preparation and settlement of these claims, the claims must be inflated by an additional 15-20%.

The goal set by Diesel in 197~~8~~4 was carried out to the letter, under the direction of Willis and Adams. The claims on their face are false and/or ficticious. It appears that the claims were deliberately designed and assembled to accomplish an illegal objective, i.e. to recover more money from the Government than NNS was legally entitled to under the contracts. If the Government can successfully argue that Willis/and company designed and assembled the claims with reckless disregard of the truth, it appears that there was a violation of Federal law in the filing of these claims.

The foregoing comments also address p. (36), para. (2) through p. 37, para. (1) which discuss the effect of an inflated claim under an FFPI contract and concludes, "Inflation or overstatement of individual cost items would not result in a dollar for dollar increase in the amounts paid to NNS". This conclusion comes at the end of a section of the memo which is titled "Failure to Prove Ficticious Manhour and Material Costs", beginning at p. 32. In a separate memorandum prepared by the writer and Ms. Adkins, this phase of the investigation is reviewed in some detail, and concludes that NNS did include ficticious costs in its claims for adjustment of the contract pricing structure. The conclusion expressed in the Bow Dome memo, however, appears to mean that it would not make any difference if there were overstatements or inflation of the claims. We think this conclusion has been refuted by the review of the contract structure, supra. If there is in fact any ficticious manhour or material cost in the NNS claims, such fictional costs were obviously intended by NNS to adjust the contract target Cost and ceiling price upward to recover a greater proportion of its incurred cost. So long as the pricing structure can be manipulated so that the actual incurred cost falls somewhere between adjusted target cost and the point of total absorption, the amount of the actual incurred cost becomes almost irrelevant.

OVERSTATEMENT OF PROJECTED COST TO COMPLETE

One aspect of the investigation of excess hours and dollars claimed by NNS was prompted by the finding by auditors and staff analysts that in certain items of the claims, the NNS calculations have used projected labor hours to complete as yet unfinished ships which were higher than NNS projections recorded in current Profit and Loss Reports, and Quarterly Cost Reports required by contract to be furnished to the Navy.

Item "VII K, ~~Description~~ DISRUPTION" of the 688 class submarine claim illustrates the calculation. In calculating the number of labor hours claimed as disruption hours, the claim pricing sheets (page IX-358 from 688 class claim attached, follow page) show that the calculation used production hours incurred to date of the calculation (in this case the calculation is dated 7/25/75, returns as of 6/29/75), plus "EST" to go" labor hours to completion, to calculate the total production labor hours to complete the ship. (Page IX-358 is pricing sheet for Hull 600 only. Separate calculations were prepared on separate pricing sheet for Hulls 602-605).

ALCULATIONS
NEWPORT NEWS SHIPBUILDING AND DRY DOCK COMPANY
FORM 194-2

H600 (2/2)

VII.K. DISRUPTION

BASED ON SSN688 RETURNS THRU 6/29/75 IT IS ESTIMATED THAT THE FOLLOWING UNITS APPLY FOR DISRUPTION:

SHOP HOURS = 32.7 % OF EST. FINAL SAY 33

SHIP HOURS = 67.3 % OF EST. FINAL SAY 67

EST MIN/HR OF DISRUPTION FOR SHOP = 5.78 SAY 5.0

EST MIN/HR OF DISRUPTION FOR SHIP = 7.33 SAY 7.0

EST MIN/HR OF DISRUPTION FOR ENGR = 3.28 SAY 3.0

PRODUCTION HOURS W/OUT SUPV. BUT INCL. G&S THRU 6/29/

= 6,218,519 HRS ÷ 1.28 = 4,858,218 HRS W/OUT G&S
EST. "TO GO" 876,181 HRS ÷ 1.28 = 684,516 " " "

TOTAL 7,094,700 5,542,734

5,542,734 x 33 % = 1,829,102 (SHOP HRS)
5,542,734 x 67 % = 3,713,632 (SHIP HRS)

ENGR HOURS (EST. FINAL) = 843,900 HRS

ALCULATIONS FOR (IX-358)
PREPARED BY JLC 7/23/75 DATE HULL NO.
APPROVED BY DATE PAGE NO.

The calculation then applies ~~on~~ an estimated "disruption factor" expressed in minutes per hour to the total, and arrives at the number of "disruption hours" claimed. The base number used in the calculation is the number "TOTAL 7,094,700".

The NNS current (as of 7/25/75) projections to complete Hull 600, according to its internal Profit and Loss Report, and the Quarterly Cost Report, were 6,328,501 hours, and 6,629,298 hours, respectively. The difference, calculated on the higher number, is 465,402 hours. For the five 688 class ships, the total overstatement of projected final hours over the current NNS Profit and Loss Reports is about 3,091,000 hours. A quick calculation, following the NNS claim calculation, indicates that using the higher projected total hours to complete results in about 300,000 labor hours claimed in 688 class claim in excess of current projections.

The preceding calculations on the disruption item are duplicated in the claim item "Deterioration of Production Labor" on 688 class, and in claim item "Deferred Work" are CGN 38-40. The detail of these calculations, prepared by staff analysts using NNS records, are held by the investigative staff.

From the prosecution point of view, the significant amount of excess labor hours and dollars included in the NNS claims as the result of overstatement of projected hours to complete, indicated that the investigation should attempt to establish whether such overstatements falsely inflated the claims against the Government.

After realizing the fact of the labor hour overstatements, and after checking various item calculations in the other three claims under investigation, it was apparent that labor hour overstatements traceable to the use of higher than current projections to complete occurred only in the 688 class submarine and CGN 38-40 claims, which were both far from completion when the claim calculations were made. In the other three claims under investigation, the ships had already been delivered or were substantially complete. It became obvious that actual labor hours incurred on these ships could be easily verified, while the 688 class and CGN contracts presented the opportunity to inflate claims by overstating the estimated hours to complete.

In the light of findings described above, a document found in material produced by NNS in response to subpoena appeared significant. The two page document, attached follow pages, has been authenticated by all of the individuals identified on the document, including R.A. Siefert, who wrote the first page text. The document has been readily identified by all individuals involved to be the request made by the claims group to the Cost Engineering Department to provide the "estimated finals" (total projected cost to complete) the 688 class ships, for use in the claim. Page two of the document has been identified as the reply, furnished by the New Construction Estimating section of the Cost Engineering Department, by Frank Silva (initials FS" on lower left) at that time head of the section. The probable finals provided, corrected for supervision and G&S hours, are the same used in the 688 class

NN 26 (3321120)

INTER-OFFICE COMMUNICATION

NEWPORT NEWS SHIPBUILDING AND DRY DOCK COMPANY
A Tenneco Company

W.T.C.
JUL 7 1975

TO: Mr. E. B. Adams, Jr.
FILE NO.
FOR: Action
DATE July 3, 1975
FROM: Manager of Cost Engineering
SUBJECT: Request for Assistance for Claims Estimates

It is requested that estimated finals be supplied from other groups in the Cost Engineering Department for production manhours (including G & S and supervision), engineering manhours, and material dollars (escalated to anticipated book cost) which correspond to the following delivery dates.

Hull	Delivery Dates (Provided by 081)
H600	June 30, 1976
H602	March 31, 1977
H603	July 31, 1977
H604	December 31, 1977
H605	May 31, 1978

The requested probable finals will be used in preparing a claim on the SSN688 class and is needed as soon as possible but not later than July 14, 1975.

J. Donald Pilland for W. T. Covington
W. T. Covington

RAS:jg
1 - W. T. Covington

PROB. FINALS*

	600H	602H	603H	604H	605H
ENGR MH	USC COST REPORT →				
PROD MH (W/SUPV.)	8088,000	6,367,000	5847,000	5,538,000	5313,000
MATL $.	29,966,000	28,546,600	29,226,500	29,979,500	29,875,900

* FROM DETAILS OF 1/75 E.F. (USING 11/74 RET.)

7/[illegible]/75

claim. All the NNS people involved have freely discussed the document, and all agree that the projected final manhours used in the 688 claim are higher than current Profit and Loss projections and that the number used came directly from the document.

All the NNS employees questioned about the matter gave the same basic rationale for the use of the higher figure, stating that the Profit and Loss projections were traditionally conservative in projecting labor cost to complete, especially where ships were still in early stages of construction, and that current new construction estimates for similar ships were more accurate. Frank Silva was questioned, and stated that his section had, at the time the information was supplied to the claim group, just completed an estimate for the construction of the Navy's next buy of 688 class ships, and the projected final hours to complete the claim ships were based upon the latest 688 class estimates.

Navy officials confirmed that NNS had submitted a proposal for the Fiscal Year 75/76 buy of 688 class, which had been prepared in early 1975. Staff analysts, with the help of Navy technicians, reviewed the NNS 75/76 proposed in detail. The FY 75/76 proposal represented that it was based upon actual costs incurred to date on Hull 600 (the first of the claim ships), plus an estimate of the projected cost to complete that ship. The reviewers then undertook to calculate back, from the FY 75/76 NNS bid, to find the number used as the base. The calculations are complicated, and not included in this summary, however, the report and calculations of the staff analyst are held by the investigative staff.

The result of the review of NNS FY 75/76 688 class bid was that the probable final labor hours (i.e., the projected total manhours to complete) Hull 600 used by New Construction estimating as the base for the FY 75/76 bid, is about 7,030,887 manhours. A tabular comparison of the various numbers for Hull 600:

Projected final: per claim:	per R&L (July 75):	per Quarterly Cost Report July 1975:	per FY 75/76 Bid:
7,094,700	6,328,501	6,629,298	7,030,887

The CGN 38-40 claim item "Deferred Work~~s~~" also uses projected total labor hours to complete, which has been compared to then current Profit and Loss Reports.

A similar overstatement to current projections is incorporated into this calculation, as in the 688 class claim. NNS claim people stated in interview and testimony that the CGN 38-40 "probable final" was also supplied by New Construction Estimating, on the same rationale as stated in connection with 688 class. The investigative staff has not located a document similar to that prepared for 688 class, although the NNS witnesses recall that there probably was a similar paper for CGN. It appears that if the rationale stated for using New Construction estimates for 688 class is acceptable, it would also be acceptable in the CGN usage, even though there is not a bid estimate available for comparison as in 688.

In summary, it appears that the use of higher than current projections to complete 688 class accounts for approximately 1,000,000 of the "excess" hours claimed in that claim when filed to the Navy, and this accounts for approximately $10 to $12 million of the dollar excess of claim over then projected cost to complete.*

The CGN 38-40 "Deferred Work" claim, although also using an inflated labor hours to complete figure, as a base, is not claimed in hours and thus does not compute into any "excess" hours claimed on that contract. The calculaton does however have the effect of overstating the dollar amount of the claim by approximately $12 to $15 million.

Based upon the foregoing, it must be concluded that the use of projected total labor hours to complete in claim calculations for 688 class and CGN 38-40, which were higher than current projections being used in NNS Profit and Loss statements, may be explained by NNS as having a "good faith" basis in the New Construction estimates.

* Approximately 300,000 hrs from disruption calculation, and about 700,000 hrs from deterioration of production labor.

Although NNS may offer the explanation as outlined above in defense of a charge of making ficticious claims against the Government, two facts should be kept in mind by the prosecution.

One, the "excess" hours claimed as the result of using new construction estimates rather than current projection for 688 class accounts for only about 1.1 million of the approximately 5 million excess manhours claimed at the time the claim was priced (July-August, 1975).

Two, at the time the 688 class claim was actually filed with the Navy in March, 1976, the first ship (Hull 600, SSN688) was within a few months of completion. The ship was delivered to the Navy in November, 1976. The NNS "Estimate of Profit and Loss" for the 3rd quarter 1976 showed 8,850,000 projected labor-hours to complete. With the ship about to deliver, total actual incurred hours could have been projected to within a few hundred hours. [illegible] Thus in the 3rd quarter of 1976 the claimed hours on SSN688 were still 596,000 production labor hours more than NNS reasonably expected to complete.

From the NNS document attached, follow page, it is apparent that on August 31, 1976, an inquiry was made within NNS, apparently by legal, requesting a comparison of total contract, claim, and change hours, to estimated final hours used in the 688 class claim as filed. Note the "xxx" next to the "estimated final" entry, and the footnote " xxx est. final based on data available 1st QTR 1975 for delivery dates specified in claim". The "estimated final" number for SSN688 is 8,088,000, the exact number supplied by

NOTE: THIS DATA IS NOT FOR [illegible]
OUTSIDE DEPTS 081 & 082. THIS IS
PRELIMINARY PLANNING DATA AND SHOULD
NOT BE CONSIDERED FINAL.

FORM 69-1 (3321468)

COMPANY CONFIDENTIAL
PRIVILEGED WORK PRODUCT OF COUNSEL

COMPANY CONFIDENTIAL
PRIVILEGED WORK PRODUCT OF COUNSEL

PRELIMINARY

TO: R. D. WARD

THE FOLLOWING DATA IS PROVIDED IN RESPONSE TO DEPT 081 (JENKINS) REQUEST ON 8/31/76

	SOURCE OF DATA	PROD HRS	ENGR HRS
SSN 688			
NEGOTIATED BASE ADJUSTED FOR MAKE / BUY	OMNIBUS CLAIM PG IX-347/348	5,643,000	831,000
CLAIM	SUMMARY OF CLAIM	3 587 229	307 715
AUTHORIZED CHANGE ORDERS	(**)	216 220	116 465
ESTIMATED FINAL (***)	OMNIBUS CLAIM PG IX-357	(*) 8 089 000	843 900
SSN 689			
NEGOTIATED BASE ADJUSTED FOR MAKE / BUY	OMNIBUS CLAIM PG IX-616/617	5,021,000	571 000
CLAIM	SUMMARY OF CLAIM	2 055 616	161 086
AUTHORIZED CHANGE ORDERS	(**)	69 854	17 512
ESTIMATED FINAL (***)	OMNIBUS CLAIM PG IX-627	(*) 6 367 000	506 000
SSN 691			
NEGOTIATED BASE ADJUSTED FOR MAKE / BUY	OMNIBUS CLAIM PG IX-870/871	4 612 000	407 000
CLAIM	SUMMARY OF CLAIM	1 639 511	120 116
AUTH	(**)	37 674	8 793
EST FINAL (***)	OMNIBUS CLAIM PG IX-879	(*) 5 847 000	386 600
SSN 693			
NEGOTIATED BASIS ADJUSTED FOR MAKE/BUY	OMNIBUS CLAIM PG IX-1121/1122	4 451 000	380 000
CLAIM	SUMMARY OF CLAIM	1 477 587	99 153
AUTH	(**)	29 764	8 346
EST FINAL (***)	OMNIBUS CLAIM PG IX-1130	(*) 5 538 000	349 900
SSN 695			
NEGOTIATED BASE ADJUSTED FOR MAKE/BUY	OMNIBUS CLAIM PG IX 1372/1373	4 291 000	365 000
CLAIM	SUMMARY OF CLAIM	1 350 419	98 264
AUTH	(**)	33 262	8 222
EST FINAL (***)	OMNIBUS CLAIM PG IX 1390	(*) 5 313 000	348 000

* ADJUSTED TO INCLUDE SUPERVISION

** CCIS SUMMARY DTD 7/30/76

(***) EST FINAL BASED ON DATA AVAILABLE 1ST QTR 1975 FOR DELIVERY DATES, SPECIFIED IN CLAIM

9

new construction estimating in July, 1975 per the document cited earlier. The significance of this document, prepared by R.A. Siefert, and initialed by W. Covington, is that someone, apparently in legal, was questioning the excess hours in the 688 claim in August, 1976, and was supplied with data incorporated into the claim in July, 1975. The SSN688 ship was within days of delivery by 9/2/76, the date of Siefert's memo, thus total actual incurred hours were easily available to Siefert, and obviously available to anyone interested in this point. ~~has been~~ Had the actual incurred to date been compared to claim the excess hours claimed for SSN688 above were 596,449 production labor hours in excess of total projected hours to complete a ship which was less than a month from delivery.

The conclusion from the above is that even if some of the excess hours in the 688 claim may be explained by NNS as having some rational basis at the time the claim was priced the explanation does not account for a fraction of the total excess hours claimed. (Roughly only 20% of the excess at time of pricing, and about 25% total actual return hours.)

Further, it is quite apparent that NNS management knew of the excess hours claimed from the time the claims were priced through to settlement of the claims in October, 1978.

Although NNS modified and in some cases withdrew individual claim items of insignificant value in their proposals for adjustments of contract target cost and ceilings, NNS made no reduction in the proposals to reflect excess hours claimed over actual incurred as these figures became available to NNS. Thus, while NNS did not misrepresent its total dollar costs to complete the ships in the various claims, NNS did include in these claims, for the purpose of adjusting the contract pricing structures to achieve a more favorable cost share, grossly inflated estimated labor hours in excess of what NNS had actually incurred (in the case of CGN 36-37 and SSN 686-687), or could reasonably expect to incurr (in the 688 class, CGN 38-40, and CVN contracts). Further, as all of these ships were completed during the negotiations with the Navy (July, 1976 through October, 1978) NNS did not correct requested target cost adjustments in the claims to reflect actual incurred labor cost.

EXHIBIT O

MARCH 5, 1980 -- MEMO FROM SAUNDRA ADKINS ON NORMAN PROSECUTION MEMO

DEPARTMENT OF THE NAVY
OFFICE OF THE GENERAL COUNSEL
WASHINGTON, D.C. 20360

LITIGATION DIVISION

/LD/SJA:msr
5 March 1980

From: Saundra J. Adkins, Special U.S. Attorney, Criminal Division, Fraud Section
To: Justine Williams, U.S. Attorney
Eliot Norman, A.U.S.A.
Linda Pence, DOJ

Subj: Prosecution Memorandum; CGN 38 Reactor Plant Ventilation Control Air System Claim

Enclosed find subject memo along with a list of exhibits and of witnesses. I am not including most of the exhibits but can provide them if you like. I am including as Attachment B, each of the six claim versions.

for

SAUNDRA J. ADKINS
Special United States Attorney
Criminal Division, Fraud Section

[illegible]

GOVERNMENT EXHIBIT 3

GRAND JURY MATERIAL
DO NOT DISCLOSE

NNS-46

Memorandum: CGN 38, Reactor Compartment Ventilation Control Air System Claim

[redacted]

[redacted]

Statement of Facts

Background

Before describing the events central to this case, it will be useful to give the reader a general view of the procurement process out of which this case arises. The Navy Department is authorized by statute to enter into contracts for ship construction. Department of Defense and Navy regulations known in the past as Armed Services Procurement Regulations (ASPR), and now as Defense Acquisition Regulations, (DAR), govern the procedures to be followed. 10 USC 2304(a) and ASPR/DAR Section III provide for procurement by negotiation rather than price competition. The regulations provide that requests for proposals (RFPs) be issued to prospective offerors. RFPs include proposed contract terms, specifications, and contract and guidance plans that define the scope of work to be contracted. Specifications describe the work in narrative. Contract Plans show work in the form of drawings including mandatory parts, arrangements and dimensions. Guidance plans show work in drawing form but the arrangements shown are not mandatory and there may be little or no dimensional information. To the extent dimensions and arrangement details are shown on a guidance plan and relied upon by an offeror they become binding contractual terms.

After contract award, the scope of work should only be changed by a formal change order issued by the Navy in the form of a Headquarters Modification Request (HMR) or a Field Modification Request (FMR). It has been determined by the Court of Claims that constructive changes can be made to the work scope by Navy issuing working drawings requiring different and/or additional work not specified by the contract plans or guidance plans. Working drawings show mandatory arrangements and dimensions in enough detail for the contractor to do the job. Under the terms of the Changes article required by law to be included in each contract, a constructive change caused by issuance of working drawings is compensable. The constructive change entitles the contractor to recover the cost incurred on account of the change as to both changed (that is new work), and unchanged, (that is disrupted and delayed work), and to receive a fair profit on that cost.

In the case at hand, NNS claims that Guidance Plan DLGN 38-800-4375731, (hereafter 731), "diagram reactor compartment ventilation control air system", was vague and misleading as evidenced by the difference between it and the working drawing, Electric Boat Plan No. 38643-01X01, (hereafter 01X01). NNS further claims that at the time NNS prepared its contract proposal in response to the Navy's RFP, that NNS could not then recognize plan 731 to be vague. NNS also claims that one could not determine from Plan 731 that the CGN 38 reactor plant VCAS was to be larger and more complex than the reactor plant ventilation system for CGN 36.

Chronology

That which follows constitutes a summary of relevant events discussed in chronological order.

In November 1969, Electric Boat Quincy, acting on behalf of the Navy as the Navy's design agent, issued Guidance Plan 731.

[redacted]

[redacted]

A fixed price incentive fee contract for the construction of the DLGN 38, 39 and 40*, was agreed to by the parties on December 21, 1971.

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted] According to his

supervisor, Larry Doyle*, Mangus may have found a draft claim prepared by persons working on the CGN 36 claim that described a potential claim on CGN 38 involving the reactor plant VCAS. [redacted]

---

*All Larry Doyle statements were made off the record in connection with a profer for immunity. [redacted]

[redacted]

[redacted]

9

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

---

*Larry Doyle, off the record, indicated he thought Larry Mangus prepared version two but could not be definitive. [redacted]

[redacted]

[redacted]

[redacted] Mr. Doyle says he did not prepare version four and thinks that Mr. Mangus did so. [redacted]

---

*Mr. Doyle believes that Mr. Alexander probably only saw the chronology at page 55 and not the annotated copy of version two at page 56-59. [redacted]

[redacted]

[redacted]

[redacted] probably added by C.L. Willis.[*]

[redacted]

---

[*] Willis's statement are made off the record. He would not specifically say what editing or rewriting he did without immunity.

[**] Doyle denies that Mangus told him that he, Mangus, was reluctant and hesitant to make the claim.

[redacted]

[redacted]

Mr. Doyle told his attorney, Fred Stant, Jr., that Mr. Mangus wrote version two. [redacted]

[redacted] Doyle says Mangus wrote four.

[redacted]

[redacted] Mr. Doyle says it came out

[redacted]

[redacted] ✓

[redacted]

[redacted]

of Willis' shop, Mr. Willis says he edited it. [redacted] Mr. Doyle agrees that Mr.Mangus wrote version six and also recalls Mr. Mangus as having been "hot" to go the change order route. [redacted]

[redacted]

[redacted]

[redacted] Larry Doyle has advised, off the record, that he saw the Krause April memo but not the June reissue by Wesley. [redacted]

[redacted]

[redacted]

Investigation

Adm. Hyman G. Rickover, Deputy Commander, Naval Sea Systems Command, by letter of July 14, 1977, to the Navy Inspector General, raised the issue whether the VCAS claim is false. The original DON to DOF referral included this issue, stating:

> Reactor Compartment Ventilation Control Air System for CGN-38, Claim Item 5.2.8
>
> Newport News Shipbuilding and Dry Dock Company (NN) has submitted a request for equitable adjustment in the amount of $989,216 (plus profit, target-to-ceiling spread and escalation) for work associated with the reactor compartment ventilation control air system. This is a system of pipes and valves that controls the flow of compressed air from the ship's compressed air system to the individual pneumatic operators on the large butterfly valves in the reactor compartment ventilation system.
>
> The Contractor alleges that it was misled by the shipbuilding specifications, allegedly vague contract guidance drawings and the lack of other design data during the bid preparation process. The Contractor states that it assumed for bid purposes that it would be building a simpler reactor compartment ventilation control air system, one similar to that in the CGN 36. NN asserts further that, subsequent to contract definitization, continued Government actions and inactions precluded it from recognizing the full effort required.
>
> The Navy's analysis of this claim item concluded that the Contractor's allegations were deficient in several significant respects. Because of the apparent discrepancy between the Contractor's allegations and the actual history of this work effort, the claim was selected for review to determine if a violation of the fraud or false claims statutes had occurred....

The Navy has concluded that this contract modification precludes the Contractor from recovering the bulk of the costs now alleged. This conclusion is based, *inter alia*, upon findings which indicate that NN had in its possession prior to contract definitization more than adequate information to assess the scope of work required to install the ventilation control air system. In November 1969, more than two years prior to contract definitization, NN was given a contract guidance drawing which in no way conflicted with the shipbuilding specifications. This drawing presented, contrary to the Contractor's allegation, a detailed diagram of the system. The extent of the detail is discussed in the Navy's technical analysis of this claim item. In addition, in mid-1972, NN received a detailed system diagram (working drawing) based upon the information contained in the aforementioned contract guidance drawing. Therefore, it is apparent that the Contractor had in its possession much more detailed knowledge than admitted by the Contractor in its claim. That this was actual rather than constructive knowledge is evidenced by the finding that in mid-1973, NN examined the information in sufficient detail to make a determination that ordering and installing certain components (not at issue here) in the air reducing station which were not shown on the contract guidance drawing represented a change in contract requirements. In spite of this knowledge, in the instant claim, NN is seeking payment for ordering and installing components listed not only in the Contract Guidance Drawing but also in the two revisions of the system diagram (working drawing) issued in mid-1972 and mid-1973 respectively.

The failure of the Contractor to admit the extent of its knowledge in the present claim may be characterized as mere advocacy considering that the Government has access to the same information as the Contractor. However, the evidence appearing to date strongly suggests a deliberate attempt on the part of NN to conceal and distort the true facts of the claim rather than an attempt to rearrange these facts in a manner

> most favorable to the Contractor. Accordingly, the Navy considers it appropriate that further investigation of this claim be conducted to determine if a violation of the fraud or false claims statutes has occurred.

FBI special agent MacLean and Special US Attorney Adkins interviewed Navy personnel knowledgeable about the VCAS-Ben Stilmar, and Robert Cohen. As a result, it became apparent that two statements made in the VCAS claim are not correct. One, the VCAS guidance plan, number 731, is not vague and does not depict a system similiar to the non-nuclear system of CGN 36, but depicts a greatly enlarged extensively redesigned and nuclear VCAS. Two, EB drawing 01X01 depicts the same work shown on guidance plan 731.

[redacted]

Having concluded that the above noted statements made in the claim are not true, the question arose who, if anyone, knew them to be false before the claim was made. Two avenues were persued in answering this question. First, all backup data existing at NNS was subpoenaed. Second, an attempt was made to track-down the author(s) of the claim. Beginning

[redacted]

[redacted]

[redacted]

[redacted] a subsequent proffer for immunity, his attorney, off the record, advised that Mr. Willis had edited the VCAS claim. Mr. Willis refused to "lay-out" this matter for the U.S. Attorney and will answer specific questions only if given immunity from prosecution.

[redacted] Subsequently, off the record, his attorney advised that Mangus never told Doyle that he, Mangus, had any concerns about the claim and that Mangus, not Doyle, was the author of versions two, three, four and six of the claim. He characterized Mangus as the moving force behind the claim, stating that no one was forcing Mangus to write the claim and that Mangus could have talked directly with Willis. It is unclear why Mr. Doyle wants immunity, since he blames either Mangus or Willis for writing each claim draft.

[redacted]

Prosecutive Theory

1. By stating that Guidance Plan 731 failed to indicate that the CGN 38 reactor plant VCAS would be different than that on CGN 36, NNS violated 18 USC 1001.
2. By making a false statement in a claim made on behalf of his employer, Larry Doyle violated 18 USC 1001.

18 USC 287 - why not?

Problems With Prosecutive Theory
----- NNS Violated 18 USC 1001

NNS's position in this matter could turn on the success or failure of prosecution of Larry Doyle. Even if Doyle were to be convicted two problems exist re prosecution of NNS. First, Doyle is a middle level employee not an officer of the company. If he failed to inform Willis that the claim may be erroneous, then one might argue that NNS cannot be held responsible. Second, NNS withdrew this claim without being advised by the Navy that the Navy had found it to be false. It would be difficult to prove NNS intended to make a false claim given their voluntarily withdrawal. See NNS's position more fully explained by their attorneys in Attachment A. ?

30

Problems With Prosecutive Theory
------ Lawrence Doyle Violated 18 USC 1001

First, only if Larry Doyle wrote or studied version four and then allowed version five to be filed can he be indicted. The evidence that he saw or studied version four is:

1) [redacted]

2) [redacted]

[redacted]

[redacted] it may prove insurmountable in proving intent. [redacted]

Third, all the witnesses will be unwilling to cooperate. They always answer questions with many generalizations and explanations focusing upon how USN and especially Adm. Rickover did so much to make contract negotiation and performance unfair, that the facts one is looking for may get lost.

Fourth, all these events happened a long time ago and its nearly impossible to overcome the many "I don't remember" answers one receives.

Finally, this is the only one of numerous claims prepared by Doyle or for which he had responsibility as to which enough evidence of wrongdoing exists to even consider indicting. It seems unlikely that he intended to file this claim knowing it to be false, if otherwise his work does not show a pattern of making intentional misstatements.

Q

Recommendations

C.L. Willis should be granted immunity in this matter. He can then be required to "lay out" the facts as he knows them. If the result shows that Doyle did intentionally prepare and make this claim knowing it to be false, then Willis can testify against him. This course, however, prevents indicting Willis, if Willis says, once granted immunity, that Doyle never really understood what statements are false but that he, Willis, did and filed the claim. On the other hand, no evidence exists that Willis knew the claim was false when it was filed, so probable cause does not exist on which to base an indictment of him anyhow.

33

EXHIBITS

[redacted]

f

[redacted]

[redacted]

Witnesses

NAME	GRAND JURY TRANSCRIPT REFERENCE
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]
Arthur J. Thomas, Jr.	302 of 6/13/79
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]
James Donald Pittard	(Interview (129-184
[redacted]	[redacted]
[redacted]	[redacted]
Joseph J. Schiller	302 of 3/28/79
Lawrence M. Doyle SJA Memos of 12-5-79 1-22-80 1/29/80	[redacted]
[redacted]	[redacted]
C.L. Willis	[redacted]

[redacted]	[redacted]
Wayne Sembower	302 of 2/13/79
William Healy	302 of 6/12/79
John Wiley, Jr.	302 of 2/16/79
Ben Stilmar	302 of 8/30/78
Robert Cohen	302 of 9/6/78
[redacted]	[redacted]

EXHIBIT P

APRIL 4, 1980 -- MEMO FROM JO ANN HARRIS TO JIM GRAHAM, ET. AL.
RE: MEETING WITH ADMIRAL RICKOVER ON NAVY RECRUITING

ROUTING AND TRANSMITTAL SLIP

Date April 4, 1980

TO: *(Name, office symbol, room number, building, Agency/Post)*	Initials	Date
1. Jim Graham		
Donald McCaffrey 2. Linda Pence		
Joe Covington 3. Ann Arbor		
Igor Kotlurchuk 4. Lorna Kent		
5.		

	Action		File		Note and Return
	Approval		For Clearance		Per Conversation
	As Requested		For Correction		Prepare Reply
	Circulate		For Your Information		See Me
	Comment		Investigate		Signature
	Coordination		Justify		

REMARKS

On March 25, 1980, the Attorney General, Jack Keeney, Joe Covington and I met with Admiral Rickover and certain members of his staff, at the Admiral's request. Attached is Jack Keeney's memo of the Attorney General's assurances to the Admiral for your information.

DO NOT use this form as a RECORD of approvals, concurrences, disposals, clearances, and similar actions

FROM: *(Name, org. symbol, Agency/Post)* Ann Harris, Chief, Fraud Section Criminal Division	Room No.—Bldg.
	Phone No.

5041-102

OPTIONAL FORM 41 (Rev. 7-76)
Prescribed by GSA
FPMR (41 CFR) 101-11.206

☆ U. S. Government Printing Office: 1979—281-184/6

UNITED STATES GOVERNMENT

Memorandum

TO : Jo Ann Harris, Chief, Fraud Section
Criminal Division

DATE: March 28, 1980

FROM : John C. Keeney
Deputy Assistant Attorney General
Criminal Division

JCK:emc

SUBJECT: Meeting with Admiral Rickover
on Navy Referrals

At the conclusion of our meeting with Admiral Rickover on March 26, the Attorney General advised the Admiral as follows:

(1) That we would pursue the submarine referrals vigorously, particularly the Electric Boat investigation, and would make certain that sufficient attorney personnel was assigned so as to thoroughly look into the matter.

(2) We would consider ways that we can be more effective in investigating and prosecuting Navy referrals and that we would even consider assigning some prosecutors to the Navy Department for brief periods of time in order to familiarize them with the Navy procedures.

(3) At the conclusion of the submarine cases we will make recommendations to the Navy with respect to underlying problems in the investigation and prosecution of Navy referrals. This would include suggestions as to changes in Navy procedures that could minimize the development of future fraud and abuse problems.

Please remind the attorneys assigned to the submarine investigations of the Attorney General's comments above.

Rec'd
MAR 31 1980

Buy U.S. Savings Bonds Regularly on the Payroll Savings Plan

EXHIBIT Q

OCTOBER 1, 1980 -- NORMAN PROSECUTION MEMO

U.S. Department of Justi

United States Attorney
Eastern District of Virginia

Post Office Box 1257
Richmond, Virginia 23210

EN:dph

October 1, 1980

Justin W. Williams
United States Attorney
Eastern District of Virginia
117 S. Washington Street
Alexandria, Virginia 22314

Re: Newport News Shipbuilding Procurement Fraud Investigation

Dear Justin:

Enclosed please find a complete set of Prosecutive Reports. They include the following:

1. Prosecutive Report--Bow Dome, SSN 688 Claim Item VII.B.8. Newport News Shipbuilding Procurement Fraud Investigation, with Comments and Exhibits.

2. Cathodic Protection Prosecution Report with Comments.

3. Prosecution Memorandum; CGN 38 Reactor Plant Ventilation Control Air System Claim.

4. Prosecution Report; Navy Recruiting--Newport News Shipbuilding Investigation.

5. Supplemental Prosecutive Report--Newport News Shipbuilding Procurement Investigation.

Sections II, V and VI of the Bow Dome Report provide the reader with a general overview of the scope of the investigation and the prosecutive theories. The Supplemental Report updates reports on specific items and discusses several general aspects of the investigation.

GRAND JURY MATERIAL
DO NOT DISCLOSE

Very truly yours,

Eliot Norman

Eliot Norman
Assistant United States Attorney

Enclosures

NNS-43

PROSECUTIVE REPORT--BOW DOME, SSN 688 CLAIM ITEM VII.B.8. NEWPORT NEWS SHIPBUILDING PROCUREMENT FRAUD INVESTIGATION

TABLE OF CONTENTS

PAGE

I. FACTS 1

II. SCOPE OF INVESTIGATION 14

III. PROSECUTIVE THEORY 17

- A. The Law 17
- B. Theory of Prosecution for the Bow Dome Item . 19

IV. SPECIFIC DEFENSES 21

V. GENERAL DEFENSES AND FACTORS AFFECTING SUCCESSFUL PROSECUTION 24

- A. Failure of Government's Overall Prosecutive Theory 24
  - 1. Failure to Establish a Pattern 27
  - 2. Failure to Prove Fictitious Manhour and Material Costs 32
  - 3. Failure to Prove That the Claims Were Written Backwards 37
  - 4. Summary 39
- B. General Nature of the NNS Claims 41
- C. Lack of Reliance on NNS' Representations . . . 46
- D. The Effect of Bridges October 4, 1978 Letter . 49

VI. RECOMMENDATION 50

GRAND JURY MATERIAL
DO NOT DISCLOSE

Eliot Norman

Eliot Norman
Assistant United States Attorney
Eastern District of Virginia
Richmond Division

GOVERNMENT
EXHIBIT
1

PROSECUTIVE REPORT--BOW DOME, SSN 688 CLAIM ITEM VII.B.8. NEWPORT NEWS SHIPBUILDING PROCUREMENT FRAUD INVESTIGATION

I. FACTS

The investigation was predicated upon receipt of information from a Navy Technical Analysist, Will Blaney, that Newport News Shipbuilding (NNS) falsely claimed it incurred additional costs due to a design change in the method (from welding to bolting) of attaching the Glass Reinforced Plastic (GRP) Bow Dome to the hull of the SSN 688 submarine.The GRP dome contains the hydrophones a and provides the submarines with sonar capability. For a view of the dome and its location on the submarine, please refer to Ward Exs. 1 and 16.

Before the details of this claim item are discussed, it is important to understand that two claims were submitted to the Navy for cost overruns on the 688 class submarines. The first or "Mini" claim was submitted in June 1975. John P. Diesel, President of NNS, and other senior management officials were led to believe by their Navy counterparts, principally Admiral Gooding and the 688 Class Program Manager Jack Wakefield, that quick submittal of a claim for design deficiencies would result in a settlement by the end of 1975 or a provisional payment. As a result of these discussions, NNS scaled down their existing rough-draft of a claim, limited it to design agent problems, reduced its value from $220 million to approximately $110 million,and sent it in in the hopes of receiving at least $50 million by the end of 1975.

One section, III.B.8, of the "Mini" claim dealt with the Bow Dome. Of the requested adjustment in target cost of $110 million in the "Mini" claim, the Bow Dome item asked for approximately $567,000 or less than 0.5 percent.

Under the Fixed Price Incentive Fee contract for the 688 class submarines, NNS could not be paid more than its actual construction costs plus a reasonable profit to be determined by the share-line figures that would be ultimately negotiated. Thus, in submitting a Request for Equitable Adjustment under the "Changes" clause of the contracts, NNS at no time represented to the governmer that it expected to be paid $110 million for the five (5) submarines or $567,000 for the Bow Dome. In fact, a request for an increase in target cost of $567,000 might result in a net increase to the contractor of only 10 percent or less of that amount.*

In Section III.B.9 of the "Mini" Claim, NNS requested $567,000 as an equitable price adjustment in target cost for added work, material and overhead incurred as a result of the government's "design agent" changing the method of attachment of the dome to the hull from welding to bolting. The "design agent" in the case of the Bow Dome was also NNS which entered into a separate design contract with the Navy. NNS thus wore two hats.

In support of the general allegation that changes in design resulted in increased costs, NNS makes a number of specific factual statements in the "Mini" Bow Dome claim. These statements can be summarized or paraphrased as follows (see Ward Ex.9): [redacted]

1. The configuration and connection method for the GRP Bow Dome was shown on Contract Guidance Drawing 800-4385833. See NNS 341 p. 30, 34.
2. The contract guidance drawing was used by the company in preparation of the estimate for fitting and connecting the bow dome to the ship's hull.
3. The company had a right to assume the information shown on the drawing was representative of the Government's requirements and provided reasonable guidance for the preparation of a sound estimate.
4. Contract Guidance Drawing 800-4385833 showed the attachment for the bow dome connected to the hull by welding.

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* The reader may wish to refer to the companion Prosecutive Reports by Ms. Adkins and Mr. Paulisch dealing with the total amounts claimed by NNS and what those dollars (amounting to in excess of $600 million in adjusted target costs) really represented.

5. Navy later discovered that the welded connection was impractical due to the weld distortion which occurred during installation by this method.

6. The Government Design Agent issued drawing Number 1290-6 which redesigned the bow dome connection to provide for a bolted connection. (NNS 341, p. 7).

7. The radical departure from the contract guidance drawing resulted in additional labor and material requirements for which the contractor is entitled to reimbursement.

8. This change in design/specification was made subsequent to contractor preparation of his bid and could not have been contemplated by the contractor.

9. Change has resulted in added costs to the contractor for which he is entitled to an equitable adjustment.

In addition to the claim narrative, NNS furnished pricing details in the "Mini" claim for each of the five (5) submarines being constructed under the two contracts. (Ward Ex.8.) A review of the pricing sheets reflected the following cost adjustments for each of the submarines due to the change in attachment method:

SHIP	ADJUSTMENT PER SHIP
SSN688 (Hull 600)	$106,024
SSN689 (Hull 602)	110,794
SSN691 (Hull 603)	111,767
SSN693 (Hull 604)	117,580
SSN695 (Hull 605)	121,594
TOTAL COST	$567,759

Each pricing sheet denoted that NNS requested an adjustment of 6,900 additional manhours for each submarine due to the change in the attachment method. The 6,900 manhours are in addition to the 4,200 manhours per hull that NNS denoted in its bid for the construction contracts.*

---

* No credit was given for the bid hours because the redesign did not reduce the welding effort "since the attachment became a built-up angle that required welding in way of the flanges." (Ward Ex. 9). See also NNS 960, p. 13.

In making its estimate of 6,900 manhours, NNS is not saying that it actually worked those hours. All that it is representing to the government is that its estimate as of a certain date (January, 1975) of the number of manhours by which the target cost of the contract should be equitably adjusted is 6,900. Prior to final negotiations under the "Changes" clause, NNS would adjust the hours in the claim so that NNS would not be paid more than the actual hours worked plus a reasonable profit.

On Ward Ex.8, the additional 6,900 manhours are broken down into two cost areas: 2,304 manhours for fabricating 192 shoulder bolts and 4,608 manhours for drilling 192 holes. The total hours translate into approximately $567,000.

The chief claims writer or team captain for SSN688 class claims was Ron D. Ward. [redacted]. Bolt stated to the Federal Bureau of Investigation (FBI) on several occasions that he was the actual author of the "Mini" version of the item and when he wrote it up he did not go back and check the original bid. Rather, he assumed that the bid was the same as the Contract Guidance Drawing; i.e.

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* [redacted]. The revised version or "Maxi" was repriced in August 1975 and sent to the government in March 1976. It asked for nearly twice as much money as the "Mini"--about $205 million dollars. On the other hand, the $205 million requested adjustment target cost was $15 million less than the claim's draft in January 1975.

that it showed a welded method.

[redacted] NNS 341, p. 84. That memo, dated November 22, 1974, from a production engineer shows that the GRP Bow Dome connection in the government's working drawings was a departure from contract guidance information and specifications. However, the memo makes no reference to how the connection was handled in the bid.

The use of this memo explains why the bid methodology was overlooked in preparing the "Mini" claim and why the error was not caught until the summer of 1975 when Ward and Bolt went back and looked at the actual bid. It also negates any inference that the false statements in the "Mini" claim regarding the bid were deliberately made.

[redacted] The bid estimate** itself makes reference to a memo by O. E. Davis, NNS 341, pp. 31-34, in which the NNS employee recommended changing the method from welding to bolting. [redacted]

[redacted]

See NNS 341, pp. 31-32.

** See NNS 960, pp. 5-8.

The July 1975 decision by Bridges, Bolt and Ward to drop the item because "the bolted attachment was included in bid" was memorialized in a July 22, 1975 hand-written memo by Ward, which was placed in the claim back-up folder, NNS341, p. 94, Ward G. J. Ex.18. [redacted]

[redacted]

[redacted]

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*It may be useful to clarify the bid process. NNS does not submit a bid to the Navy for each item on the submarine. It submits one total bid for the entire submarine; or, if a contract includes more than one submarine, for the fleet or class. That dollar figure in the case of the 688 submarine was $77 million in target cost. It is supported by bid estimate data which correspo to various cost accounting numbers used internally by NNS in building the ship. These bid estimates are made available to the Navy for its review in negotiating a final contract price. That contract price may or may not be the same as the bid submitted by NNS.

In the case of the 688 class submarines, the 688 or lead shi was a negotiated, "sole source" procurement. Newport News' bid for that ship was $77 million in target cost. NNS was awarded th contract at $66.5 million in target cost. The difference in the total bid contract price was $97.6 million as submitted by NNS and $83.0 million as awarded by the Navy. The follow ships which NNS constructed were bid in competition with Electric Boat and Ingalls. NNS was awarded four follow ships, Electric Boat was awarded seven. The total target cost on the four ships (SSN 689, 691, 693 and 695) was $225.1 million. NNS bid approximately $232 million for those four ships.

In its request for equitable adjustment, NNS sought to incre the target cost for the 688 submarine by some $58 million--from $66.5 million to approximately $130 million (escalation included) For the four follow ships, NNS sought to increase the target cost by $141 million from $225 million to approximately $403 million (escalation included). For the two contracts NNS was seeking a $200 million increase in target cost, equal to a 71 percent incre

[redacted]

[redacted].

[redacted]

Ward's report to Willis, dated 12 August 1975, simply states that the GRP item will be reinstated per Willis' direction, NNS 281 p. 73 . Willis' 3-page report to Creech on progress on the claims (NNS 281, pp. 68-70) states at page 69 that a comprehensive reanalysis of the contract requirements for the item led to decision by Willis and Beauregard to put the Bow Dome back in.

[redacted]

[redacted].

[redacted] and other documents such as Ward Ex. 7, establish that the meetings with Beauregard reversing Ward's 22 July 1975 decision to drop the item occurred sometime between 5 August 1975 and 8 August 1975.

[redacted]

[redacted]

[redacted]

The claim narrative was not reinserted in the Maxi claim as written for the "Mini" claim. Willis personally revised the claim to eliminate those statements that were no longer supported by the research of Ward and his assistant, Bolt, during the summer of 1975. See NNS 341, pp. 43-44. [redacted]

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* See NNS 341, p. 36.

[redacted]

[redacted]

[redacted] Prior to submission of the "Maxi", the Navy analysts had concentrated on the delay portions of the 688 "Mini" claim and had not made any determinations one way or the other on entitlement for the Bow Dome.

[redacted] One of the comments, NNS 341, p. 38, deals with the Bow Dome. That comment confirms that Beauregard saw the Ward memo dated 22 July 1975 which recommended that the claim be dropped, see NNS 341, p. 94. [redacted]

[redacted]

During 1976 the Navy began in earnest to review the "hardware" items in the 688 claim, including the Bow Dome. The final recommendation of the Navy Claims Settlement Board was to pay nothing on the item because the design change was picked up in the bid process. This specific recommendation was not communicated to NNS during negotiations. Instead of negotiating and paying the claims on a line-by-line basis, the Navy preferred to submit one lump sum offer for the entire SSN 688 claim. This lump sum was not broken down into its components. The Navy did not rely too much on the claim narrative or on the claim pricing in paying the Bow Dome or any other item. The Navy analysts would also testify that they disregarded any factual statements in the "Mini" claim once it was supplanted by the "Maxi" in March of 1976. The Navy and Defense Contract Audit Agency (DCAA) did not address any interrogatories or questions to NNS during claims negotiations which dealt with the welding v. bolting issue on the Bow Dome. Nor were any supplementary representations made by NNS during 1976 and 1977.

[redacted]

[redacted] Covington in NNS 341, pp. 25-26 concluded that the bid proposal was based on the bolted method, a fact that Ward et al first learned in July, 1975. Covington also suggested that legal review and opinion on the relevance of the bid proposal to entitlem be obtained. He subscribed in his memo to the theory that the overall reduction in contract price for the SSN 688 Class meant that the bid estimates were irrelevant.

By February,1978 Admiral Rickover had gone public with some of his charges of fraud in the NNS claims. This item was not one of those mentioned but his overall allegations prompted the active involvement of Dilworth, Paxson of Philadelphia in the claims review process. [redacted]

Whatever the disagreement, it did not lead to formal withdrawal of the Bow Dome item. However, on 4 October 1978, the day before settlement of the 688 claims, Bridges sent to the Navy a letter concerning the Bow Dome. The letter, NNS 538, pp. 3-4, was submitted for purposes of complying with the Truth-In-Negotiati Act, Pub. Law 87-653, because "continuing review" revealed several areas in which corrections were in order. Regarding the GRP Dome, Bridges informed the Navy that review of the section indicated that a design similar to the one in the Navy working drawings was included in the bid proposal. Bridges did not withdraw the item bu assured the Navy that further review would be conducted to determin whether the design was in fact the same. One can infer from the letter that if there were only minor differences or no differences, NNS would reduce the requested adjustment and target cost according

On 5 October 1978 the Navy settled the SSN 688 claims. NNS was paid approximately $48 million on the 688 claims. The lump sum settlement does not break out any of the items. The Navy Claims Settlement Board files reveal, however, that no money was paid on the Bow Dome.

II. SCOPE OF INVESTIGATION

The 688 Class claims were under active investigation from August, 1978 to November, 1979. Approximately one-half of the staff's resources were devoted to the claims, principally because they seemed to offer the best possibilities for prosecution of a wide range of "hardware" and delay-related items, many of which were in non-nuclear areas.* The saga of the "Mini" v. "Maxi" versions and the [redacted]

[redacted]

---

*The non-nuclear items offered better possibilities because they were less complex and did not involve disputes over whether a change was ordered by NNS in its "RPPY" or in its "Conractor" capacity. RPPY is an acronym for Reactor Plant Planning Yard, a government agent. Several key engineers including Don Kane worked for RPPY and NNS. [redacted] NAVSEA 08 almost always disagreed with Newport News' interpretation of the scope of RPPY responsibilities and claimed fraud in each and every case in which allegations involving RPPY were involved. As will be detailed in Prosecutive Reports, the contractual question of RPPY v. NNS continues unresolv until this day [redacted]. The truth probably lies somewhere in between the positions of NAVSEA 08 and NNS but in any case such disputes are inappropriate matters for a criminal fraud prosecution.

[redacted] Approximately 1500-2000 pages of grand jury testimony on the 688 claims was taken. [redacted]

[redacted]ally, Navy officials such as Admiral Manganaro, Admiral Eustace and the 688 Project Manager, Jack Wakefield, are available to describe the sequence of 688 claims submissions and the Navy's overall analysis thereof.

In its examination of these witnesses, the staff has not suffered from any lack of documentation concerning the writing and submission of the Bow Dome item. [redacted]

[redacted]

It should be understood that this documentation regarding the Bow Dome has been selected from thousands of other documents produced at depositories at Newport News and Richmond. Staff attorneys, agents and Will Blaney, a full-time consultant, reviewed no less than 100 boxes of documents dealing with the 688 submarines. This volume of 500,000 or more pages of correspondence, technical data, and drafts of claims sections came from the following location

[redacted]

In researching information [redacted]nd Navy files, the staff also benefited from prompt production of various document indexes, both manual and computerized. These indexes and the use of paralegals and technical consultants provided a reasonable degree of certainty that critical items of information were not over-looked in the course of document searches and bi-weekly preparation for grand jury sessions.

III. PROSECUTIVE THEORY

A. The Law

The obvious vehicle for prosecution is the False Claims Act, 18 U.S.C., Section 287. That section punishes by fine, imprisonment or both anyone who makes or presents a claim upon the United States or any of its agencies "knowing such claim to be false, fictitious, or fraudulent..." Although the intent essential for conviction under Section 287 need not be an intent to defraud, the statute clearly requires something more than reckless indifference. The leading case in the Fourth Circuit is United States v. Maher, 582 F.2nd 842 (1978). In Maher, the defendant argued on appeal that the trial court committed error in refusing to instruct the jury that the intent essential for a conviction is limited to "a specific intent to defraud the government," id. at 847. The Court of Appeals disagreed. Its specific holding on the issue of criminal intent was that the trial court properly instructed that:

> Section 287 may be violated by the submission of a false claim, a fictitious claim or a fraudulent claim, if, in each instance, the defendant acted with knowledge that the claim was false or fictitious or fraudulent and with a consciousness that he was either doing something which was wrong... or which violated the law.

Id at 847. In so approving the jury instruction, the Fourth Circuit endorsed the addition of the element of "willfullness" to the requirements of the government's case under Section 287.*

The Fourth Circuit in Maher equates the element of "willfullnes with criminal intent, id. at 847. In turn, criminal intent requires proof that the "defendant acted for a specific purpose to violate the law or that he acted with an awareness that what he was doing was morally wrong..." Id.

---

*The Fourth Circuit's endorsement of the addition of this element is consistent with the approach taken by the Eighth Circuit in Johnson v. United States, 410 F.2d 38 (1968).

Both this definition and the District Court's jury instructic on criminal intent in a Section 287 case mean that proof of reckless indifference as to whether the claim was true or false will not be enough. The one jury instruction in Maher that referred to reckless disregard of the truth made it clear that such proof would be insufficient:

> In this regard, however, you are told that ...the contractor...had no right to put on a voucher, a claim for payment for work that he knew had not been done or put on such a voucher a claim for payment with reckless indifference as to whether the work had been done or not, that is, or whether the claim was true or false.
>
> However, even if this is shown, the defendant cannot be convicted unless it is shown that he acted with a specific intent as that term...will be defined for you...
>
> To establish specific intent the government must prove the defendant knowingly did an act which the law forbids purposely intending to violate the law...that is, he must have had a consciousness that what he was doing was wrong. [Maher at 846.]

Any last doubts that reckless disregard of the truth will be sufficient are dispelled by the language in Maher at 847-848. At 847 the Court of Appeals notes that Section 287 is silent on motive and criminal intent and "does not require proof of a specific intent to defraud, as defendant defines that term, because the purpose of Section 287 will not be furthered by limiting criminal prosecutions to instances where the defendant is motivated solely by an intent to cheat the government or to gain an unjust benefit." The Fourth Circuit goes on at 848, however, to state that under Section 287, "the government must prove beyond a reasonable doubt that the defendant performed forbidden acts with a criminal intent." And as discussed above, the Court's definition of criminal intent requires proof of "a consciousness that he was either doing something that was wrong...or which violated the law... id. at 847.

B. Theory of Prosecution for the Bow Dome Item

The key prosecutable event is the [redacted]. No prosecution can be maintained for any false statements in the item as originally submitted with the "Mini" claim in June of 1975 to the Navy because it is clear that the false statements in the claim were due to the negligent failure of Ward and Bolt to check the original bid.

As between Beauregard and Willis, the latter holds very little attractiveness for prosecution under 18 U.S.C., Sections 1001 or 287. [redacted] On these facts, prosecution of Willis or any of his subordinates would not survive a Rule 12 Motion asserting good faith reliance on the advice of counsel, United States v. Kahn. 381 F.2d 824 cert. den. 389 U.S. 1015 (6th Cir., 1967).

[redacted]. There is no prosecution route above Willis since we have no evidence that anyone outside of Contract Controls had any knowledge of the details of the Bow Dome Item. All this leaves Beauregard as the only likely target, [redacted]

To prosecute Beauregard, the Government must show he knew there was no good faith basis for his legal theory of entitlement. In other words, he knew it was wrong or in violation of the False Claims Act to go forward with the item; and came up with a phony legal rationale to convince Willis and Ward.

Any proof regarding Beauregard's specific intent is at best circumstantial. [redacted]

[redacted]

IV. SPECIFIC DEFENSES

Willis' defense of good faith reliance upon counsel has already been mentioned. [redacted].

Beauregard can answer each aspect of the prosecution's case as follows. Regarding deletion of any reference to the bid in the claim, Beauregard can argue that he was not required to set forth his legal explanation for the irrelevancy of the bid in the factual narrative. He can point to the total absence of any legal theories in the other factual narratives submitted by NNS as proof that legal theories were left for the complaint to be filed before the ASBCA. In other words, because of the format of the Request for Equitable Adjustment, no inference can be drawn one way or the other from the absence of references to the bid or of explanations of what he considered to be immaterial facts.

Regarding his knowledge at the time that actual returns were running less than the bid, Beauregard would say that the amount of cost in the bid is irrelevant from a legal point of view and therefore it didn't matter whether NNS was overrunning or underrunning its bid. He would also point out that the actual returns were not final and thus it was not known at that time if there would or would not be an overrun. In this regard, all he was recommending was that a claim be filed for the difference between Navy working drawings and the Navy contract guidance drawing. If it turned out there was no difference

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[redacted]

NNS would still have a valid claim; only it would be for zero dollars. His job was only to determine whether there was a legal basis for recovering increased costs, whatever they were. [redacted]

Beauregard could also point to the fact that the contract for the entire submarine was not based on Newport News' bid estimates. When the Navy rejected NNS's bid of 77.5 million, everyone was back to ground zero. NNS was thus entitled to price the contract on the welding method in the Contract Guidance Drawing; and was further entitled to an equitable adjustment under the "Changes" clause if the Navy required a more expensive method (bolting) when it issued the working drawings. Since the bolting method was, in fact, more expensive, they claim section had a basis in law and fact.

Regarding the 1978 disagreement with Beauregard's legal analysis by Newport News' other law firms, Beauregard would say that no two lawyers ever agree all of the time on everything. He would argue that such disagreement does not mean that his initial legal theory was without a good faith basis, even if erroneous. Also, by 1978 events regarding public allegations of fraud dictated an abundance of caution in the advice given by outside counsel. The October, 1978 letter by Bridges to the Navy (stating that the item was under review and would probably be revised) was not an admission of fraud. Rather, it simply indicated a change in legal analysis and a good faith effort to comply with the Truth-In-Negotiations-Act.

As to Beauregard's motive in approving the re-submission and revision of the claim, Beauregard would testify that all changes made under his general advice and supervision were designed to eliminate the false statements in the original draft of the item. Thus, his intent was not to deceive the government but to correctly state the facts and to request an adjustment which had a colorable legal basis. The Navy could disagree with the law but it could not question the facts. As rewritten the narrative contains only true statements. Any refusal to pay NNS the difference between the cheaper method shown on the Contract Guidance Drawing and the Government's working drawings, which were issued after contract award, would have to be based on legal, not factual grounds.

Finally, Beauregard's most obvious defense would be to cite some legal authority for his position. Somewhere in the field of public contract law, authority may exist for holding that the bid methodology is irrelevant if the bid is not used as the basis of the contract. The contractor incurred increased costs if the point of comparison is the Contract Guidance Plan's welded method and there may be authority for making the comparison that is made in the claim. Even in the absence of published citations, Beauregard could point to internal law firm memoranda advocating that a new legal principle be tested. Any or all of this kind of evidence would go far in negating the specific intent required to convict.

V.

GENERAL DEFENSES AND FACTORS AFFECTING SUCCESSFUL PROSECUTION

Included herein are defenses which transcend the particular facts of the Bow Dome Item. There are also a number of general factors affecting prosecution of the case which overlap with these general defenses. For this reason, such factors are discussed in this section.

A. Failure of Government's Overall Prosecutive Theory.

Proof of motive is not an essential requirement of the government's case but it helps. Where there is no discernible motive, defense counsel can implant reasonable doubt in the minds of the jurors concerning the existence of criminal intent. The problem with the government's case on the Bow Dome or on any other individu item is the lack of connection between the item and a general scheme to defraud. The absence of any link between the item and the hundreds of millions of dollars of claims which preoccupied nearly all of Will's and Beauregard's time will have a negative impact on the prosecution.

To understand the importance of the failure to establish such a link, one might begin by explaining the staff's initial prosecuti theory. During the initial months of the investigation, the following scenario emerged from review of the company records. In 1973 Jack Diesel took over effective control of the shipyard. He soon realized that the company was in serious financial straights with rspect to its Navy shipbuilding program. A series of contract signed in the late 1960s and 1970 for nuclear submarines, cruisers, and aircraft carriers were experiencing hundreds of millions of dollars in cost overruns. Not enough attention or priority was being given to preparing change orders or claims by the NNS Contrac Department.

By mid 1974, the situation had not improved. Jack Diesel's efforts to free up more money through lobbying in Washington, D.C., and via non-contractual mechanisims such as 85-804 legislation were not meeting with success. Back at the yard the value of the claims then generated by an informal Contract Liason Group were relatively small and way below the expected overruns on the nuclear vessles.

In response to this crisis, Diesel reorganized. In August, 1974, he scrapped the Liason group and established a new Contract Controls Department under Len Willis. This Department, which soon grew to 150 permanent and as many as 500 different part-time employees, was given top priority in generating requests for equitable adjustment of the Navy contracts. Diesel immediately got results. By the end of 1974 claims in draft form requesting adjustments in target costs of $500 million had been prepared.

[redacted]

All this playing with figures suggested to the investigative staff that the claims were being written backwards under pressure from Diesel to come up with a recovery that would wipe out the losses on the contracts. It appeared that the target value was established first and the claims were being written to suit that monetary goal. It was thought that this type of downward pressure would result in a number of false or fictitious items being "ginned up" in support of an artificial edifice.

The staff expected that any efforts to immediately establish a grand conspiracy by interrogating top management would be met with stiff resistance. Instead, two alternative approaches were used by the staff to establish that the entire claim was deliberatel inflated to meet pre-arranged dollar targets. First, a team of DCAA and FBI accountants was set up to prove from the company's own books that NNS requested payment in the claims for millions of manhours that it never worked or expected to work. Second, a simultaneous effort was made to establish a pattern of deliberate false statements in several of the small items in each of the major claims. It was thought that successful prosecution of Willis and the claims writers on the small items would force them to reveal how the entire claim was based on fictitous labor and material costs.* If these witnesses could be broken, they would enable the prosecution to move up the corporate hierarchy to Dart (Executive Vice President of Contracts) and Diesel.

As the investigation progressed, both of these alternative prosecution strategies did not meet with success. They failed because a number of essential assumptions underlying the prosecutiv theory proved to be erroneous. Contrary to earlier beliefs, NNS did not misrepresent to the Navy its Estimated Final Costs for construction of the SSN 688 submarines and other Navy vessels. And top managment at NNS did not write or rewrite the claims to fit pre-determined target values.

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* To take the SSN 688 claim as an example, this request for equitable adjustment amounted to $58 million in target costs. Close to $40 million of that claim was for delay, disruption, deferred work and related "ripple-effect" type damages. These "ripple" items were in turn based upon tangible hardware and structural matters such as piping, machinery, and the Bow Dome. If it could be shown that these building blocks upon which the entire claim is based were false or fradulent, the structure of the entire $58 million claim could be shaken. And the entire structure would collapse once it was shown that 10 percent or 20 percent of the $58 million requested reimbursement for labor and material costs that were not incurred and were not expected to be incurred by the contractor.

1. Failure to Establish a Pattern.

Regarding proof of a pattern of deliberate misstatements in a number of small items, the facts are as follows. There are approximately 63 items making up the SSN 688 claim. They range in size from $75,000 for the Bow Dome to $1.7 million for platforms to $26.1 million for delay. The 63 items total approximately $58 million in proposed target cost increases. There are a similar number of items for a second claim for the four follow ships in the SSN 688 class. Together, both claims request increases in target costs of about $200 million.

The two SSN 688 class claims have been subject to extensive technical analysis by the Navy for over two years and by the investigative staff for nearly 18 months. The Navy kept meticulous records of progress on the 688 submarines, required numerous technical reports from NNS during construction, and had its own inspectors in the yard overseeing design and construction throughout the building process. Because the government subpoenaed the claim back-up files that would have been used by NNS to substantiate the case before the ASBCA, staff technical consultants such as Will Blaney were able to double check the Navy's earlier technical review of the claims. The results were substantially the same. Of the 63 items in the requests for equitable adjustment, fewer than six (6) appeared at one time or another during the course of the investigation to be factually incorrect. These items amounted to less than 4 percent of the total requested adjustment in target costs.

The items which warranted further investigation and the many other items which have a substantial factual basis were written in the same way. [redacted]

[redacted]. The result is a claims writing process from the bottom up, not from the top down.

[redacted]

[redacted]

The overall impression is one of technical integrity and precision in the claims writing process. The substantial paper produced and reviewed confirms that the claims were written by technical people who had no link with even Len Willis, let alone top management like Diesel or Dart. There is no evidence of pressure on the several hundred technical people to produce a certain value or number of items in response to managment goals of booking $200 million on the claims. The prosecution staff cannot disprove consistent statements from top to bottom in the claims writing teams that [redacted] With respect to the basic components of the SSN 688 claim, that division of responsibility between developing a factual narrative and pricing the consequences was strictly maintained.

On the subject of the target values for the claims [redacted]

Whether one reviews the Navy files or the NNS files to check out the facts, the SSN 688 "hardware" items have a substantial factual basis. Some of the harshest critics of the NNS requests for equitable adjustment do not dispute the integrity of their basic components. Don Matteo, for example, is a submarine engineer who made most of the referrals of fraud on the SSN 688 claim and spent two years reviewing it. He believes that a first rate job was done in putting together the facts in support of the claims. When the Navy refused to pay individual items during settlement negotiations, it did so not because the facts were incorrect but because it interpreted the contract differently.

When the staff initiated its inquiry, it thought it was looking at the tip of an iceberg. The staff has found, however, that most of the alleged misstatements in the handful of items warranting further investigation cannot be proved. And the remainin structural, shielding, piping, machinery, and electrical items are factually correct.

The discovery that the suspected iceberg is instead an isolated, small ice floe has a number of important consequences. The absence of any structure hidden beneath the surface means that successful prosecution on the Bow Dome will have no dividends elsewhere in the claim. No matter how much more time is expended on this investigation, better than 98 percent of the facts in the basic items making up the SSN 688 claim cannot be proved wrong. The theory that $8 million worth of "hardware" items were inflated and "ginned up" to serve as multipliers for an inflated and distorte delay claim does not wash.* Thus, proof of a false Bow Dome claim will not have horizontal or vertical benefits. It will not lead to prosecution of other "hardware" items or give rise to the inference that the item was created so that NNS could recoup millions for delay to hull construction.

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*The multiplier effect works like this. In order to blame the Navy for two years worth of delay on the ship, NNS must attribute the delay to specific design changes which impacted construction. Each of the 40 "hardware" items concern themselves with such changes. The individual items claim compensation for added work. But they also serve as justification for the ripple effect of delay damages. Thus, if these items have no integrity, there is no basis for the delay claim. And without delay and its associated damage claims for disruption and deferred work, NNS would not have the building blocks for a multi-million dollar request for equitable adjustment.

It may be helpful to compare the NNS claim with the delay claim of Litton that is now under indictment. In Litton, facts were selectively chosen and woven into the fabric of a unified, forty-two (42) page claim for delay. Lower level claims writers with no technical background or apparent liason with technical personnel were instructed to come up with the facts "to fit" a particular theory. To meet these theories charts were back dated and facts were dreamed up and distorted through revision after revision until everything fit.

Like the Litton claim, NNS does attempt to sell a theory to the government: namely, that because of numerous design changes, the Navy should pay for added work and for the "ripple" effect of its actions. Unlike Litton, however, the claim is supported by 15 volumes containing factual narratives, cost estimates, blue prints, and chronologies of relevant correspondence. It is further divided into sixty (60) odd sections, each of which has an integrity of its own. Instead of selectively weaving certain facts into a delay claim, NNS lays out forty (40) different substantive, tangible events. It is beyond dispute that over 95 percent of these events occurred as NNS says they did. NNS then uses these separate events to argue that the Navy is responsible for their "ripple effect": two years of delay on the 688 submarine and corresponding delay on the follow ships.

The Navy can disagree with the "ripple" theories. The Navy can use its own computer analysis to establish that the "ripple effect" was not as great as NNS alleges. The Navy can argue that a more reasonable estimate of the delay would assess some of responsibility for delay on the contractor. The Navy can also disagree that under the contract it was responsible for all of the forty (40) events. But the Navy cannot take factual issue with the underlying events as described by NNS.

This type of claim structure, which apparently was designed by one of the three law firms assigned to NNS to oversee the claims effort, makes any criminal prosecution difficult. As long as there is integrity to the forty (40) structural, shielding, piping, machinery, and electrical items, the battleground shifts to matters inappropriate for fraud prosecution: legal interpretati of Navy contracts and theories of proof of "ripple-effect" damages.

2. Failure to Prove Fictitious Manhour and Material Costs.

The structure of the NNS SSN 688 claim would still not bar a criminal prosecution if the staff's second alternative prosecutive strategy proved successful. The reader will recall that the staff also sought to prove that in requesting $200 million for the 688 submarines, NNS deliberately overstated the amount of "ripple-effect" damages so that the contractor was asking to be paid for millions of manhours that were never worked or expected to be worked. Under this alternative theory, although there might be nothing wrong with the "hardware" items, the total claim could stil be inflated to $200 million by using "bogus" calculations for delay, deferred work and disruption.**

This prosecutive theory appeared to have greater chances of success as the investigation progressed. Far fewer people were involved in calculating the final dollar amounts to be sent over to the Navy. [redacted]

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* The amount of delay, deferred work and disruption attributable to a particular event can be estimated but is not subject to stric proof. In the final analysis no one really knows how much delay w a result of Navy versus NNS actions.

** One can distinguish the two prosecutive strategies by reflectin on the process of multiplication. Multiplication invloves two numbers: the multiplicand which is multiplied by the multiplier. In the NNS claims, the multiplicand is made up of "hardware" items like the Bow Dome. The multiplier is often a subjective calculati derived from looking at labor rates or Estimates of Final Cost. I would be entirely possible for there to be nothing wrong with the multiplicand, yet wind up with a claim for costs that were never incurred by "ginning" up the various multipliers. The staff looke at both parts of the multiplication process with the results as detailed above.

*** "Software" refers to delay, disruption and deferred work.

[redacted]

One of the first areas that this aspect of the investigation focused upon was the calculation of deferred work and deterioration of labor. These two components of the overall delay claim amounted to approximately $18 million for the SSN 688 submarine and in excess of $60 million for the four(4) follow ships. Initial interviews and [redacted] It was believed that deferred work and deterioration of labor were overstated by approximately 20 percent and that no good-faith justification could be made for the calculations involved in these items. However, after further review and extensive interviews with [redacted], the staff reversed its earlier position. In the final analysis, NNS did not take advantage of an opportunity to inflate either item and accurately stated in its calculation of these delay elements its Estimated Final Costs.

From its analysis, the staff also concluded that items like the Bow Dome were not used to inflate the calculations for deferred work and deterioration of labor.* A staff consultant, Will Blaney, traced the calculations back to bid estimates and determined that the estimated final costs used to calculate key aspects of the delay claim were the same as those shown on internal Profit and Loss Statements (audited by Arthur Anderson) and on bid documents for future procurements submitted to the Navy by NNS. However large the calculations for delay may appear, their integrity could not be shaken.

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*For example, actual returns of 3200 hours for the Bow Dome in place of the requested adjustment in target cost of 4600 hours were used to calculate delay.

Much time and effort was also devoted to proving that an attempt was made in the claims to deceive the Navy as to the actual costs incurred in construction of the ships. To that end, accountants were assigned on a full-time basis from the DCAA Office in Philadelphia to the investigation for a period of approximately four to six months. The accountants were asked to confirm that the figures supplied to the Navy were grossly inflated. It was believed that a $150 million discrepancy existed between actual construction costs and the dollars requested in the claims. Numerous financial records, including internal, confidential Profit and Loss statements and accountant's work papers were subpoenaed by the grand jury from NNS and their accountants, Arthur Anderson.

In the case of the SSN 688 class submarines, initial analysis showed that NNS was claiming 5.1 million manhours in excess of the hours worked or expected to be worked on the vessels. This claim for fictitious manhours amounted to $67.9 million in excess target costs and, if paid, enabled NNS to capture an excess profit of $24.6 million. During settlement negotiations in late March, 1978, Admiral Manganaro, told Dart, Willis, Bridges and Ward, that NNS was claiming 5 million more manhours than it worked or expected to work. Manganaro received no response other than Dart's retort that a comparison between actual costs and the costs in the claims was "irrelevant". NNS also overstated material costs in its Request for Equitable Adjustment for the 688 submarines.*

Late in the investigation, however, the staff discovered that NNS did not represent to the Navy that it had expended manhours and material costs which were fictitious. In each of the claims, NNS told the Navy flat out what the estimated final construction costs for each boat were. And these cost figures were current, accurate and complete as of the date of submission of the claims. They also were supplemented by Willis on at least one occasion prior to settlement of the proposals for equitable adjustment. The effect of these straight-forward representations meant that NNS was not asking to be paid (under the contract, adjudicated change orders and claims) for work that had never been done and was never expected to be performed.** All that NNS was requesting was that a new target cost figure be adopted in order to draw a new share line. NNS was not asking to be paid the new target cost amount. Any difference between the target cost and the actual construction costs represented nothing more than an equitable profit on the contracts which the Navy could recognize if it accepted NNS's position that it would have underrun the original target cost of the contracts had there been no Navy interferences with ship construction.

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*A similar situation existed with respect to the other claims. With only few exceptions, NNS claimed more in material and labor costs that it spent or expected to spend in terms of setting new target costs.

**Take, for example, the 688 submarine. When the claim was submitted in March of 1976, the submarine was 95 percent complete. Its estimated final cost was $114 million. Under the contract and adjudicated change orders, NNS was entitled to be paid $70 million for its costs. In its claim, NNS asked for an additional $58 million, thus raising the total contract target cost to $130 million or $16 million more than estimated final costs. The catch is that NNS never represented to the government that the boat cost $130 million. All that the $130 million represented was an adjustm in the contract target cost so that a new share line could be drawn which would increase the amount of profit to be received by NNS for constucting the 688 submarine. To put it another way, NNS told the government that the $16 million differnce represented the percentage by which NNS would have underrun the target cost of the original contract had there been no Navy interference with design and construction. The $16 million was no more and no less than an equitable adjustment for lost profits.

The short and long of it is that NNS never concealed or misrepresented in its claims its true estimated final costs of construction. The request for $58 million in target cost increases for the 688 submarine was no more than a proposal for an equitable increase in a target figure that could be used as a vehicle for drawing a new share line.

In its 688 claim, NNS estimated that about a $60 million increase in the $70 million target cost would be necessary to put the contractor back in the position it would have enjoyed had there been no Navy interference with performance. Setting the target cost at $130 million would mean that NNS would earn about the same percentage profit (13%) at $114 million in costs that it would have enjoyed if it had been able to build the ship for $54 million. NNS can claim that it would have underrun the original target cost of $70 million by pointing out that actual construction costs ($114 million) less the estimated value of Navy unilateral changes and delays ($60 million) is $54 million or $16 million under target. Thus, NNS is not asking to be paid for $16 million in costs that did not occur when it proposes that a new shareline be drawn with $130 million as its target cost. Rather, the $16 million simply represents lost profits of 13% on a six year $114 million construction effort.

The Navy is free to accept this figure or suggest another as a more appropriate measure of what NNS would have spent to complete the ship if it had been built according to original contract specifications. But like "ripple-effect" damages, a hypothetical underrun cannot be proved or disproved with any precision.

The Navy may also disagree with NNS' estimates of the costs to the contractor of Navy design changes and other actions. At no time, however, does NNS request the government to pay construction costs in excess of Estimated Final Costs of $114 million. And that $114 million figure is a true measure of the manhours and material expended by the contractor.

NNS accepted in its claim the principle that it would never be paid more than its actual construction costs and correctly represen those costs to the Navy.

Since NNS wasn't fooling anyone in the Navy concerning the amount of its contract construction costs, one cannot infer any motive for inflating individual claim items. Inflation or overstatement of individual cost items would not result in a dollar for dollar increase in the amounts paid to NNS. Thus, there is no pyramid to topple. The Bow Dome and any other suspected items are not cornerstones of an artifical, inflated edifice, but isolated stones that were never rolled into place. Prosecution of any individual item will not reveal an effort to inflate the total claim amounts since at no time did NNS represent to the Navy that it expected to be paid for construction costs that were never incurred or expected to be incurred.

3. Failure to Prove That the Claims Were Written Backwards

As the investigation progressed, one other important area of proof did not materialize. It was believed that NNS booked $200 million as an asset on its internal Profit and Loss Statement before any of the claims were written. This $200 million figure represented what NNS expected to collect from the Navy on the claims. It was thought that the $200 million book value generated pressure on lower level employees to come up with enough claim items to meet pre-arranged dollar targets. To recover $200 millior cash and for the Navy to sell such a settlement to Congress, NNS would need to generate at least a $600 million requested increase in target costs.

Late in the investigation, however, this prosecutive theory unraveled. The staff found out that no set value of $200 million for the claims was booked in advance. [redacted]

[redacted]

These adjustments were made on a quarterly basis. The same procedure was used for booking the "discounted" value of unadjudicated change orders. Historically, NNS collected about 46 percent of the face value of its claims. The discounted value of the NNS claims to the Navy that are the subject of the investigation varied between 50 percent and 33 percent on the company's books. The staff found no significant difference between the way the book value for these claims was arrived at* and the way that NNS historically calculated the book value of claims or unpaid change orders during the previous seven (7) years. In all cases the numbers were arrived at after the claims or change orders were written and were based on recommendations from line people, not top management.

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* Review of Profit and Loss Statements reveals that in the fall of 1974 when the Contract Controls Group was set up, Diesel and Dart booked only $12 million on the 688 claims. At that time, change orders had been submitted totalling $25 million. The discounted value did not change in the 4th quarter of 1974 despite the fact that Ward established the stab-value of his 688 claims at $220 million. Only after the "mini" claim was sent in to the Navy in the 3rd quarter of 1975 asking for an increase in target cost of $110 million were any changes made on the company's books. [redacted]

This same pattern was repeated for all the other claims and unadjudicated change orders. Thus, it is not true that Diesel and Dart selected an expected recovery figure in advance and then exerted pressure from on high to generate claims to support it.

4. Summary

By the end of the investigation, each aspect of the prosecution general theory could not be supported by the facts. The staff discovered that the target values for the claims did not dictate what was written about a claim item or how it was priced. Nor was there any fixed recovery value for the claims which led to the establishment of the target values. The claims writing process had substantial integrity, was correct on its facts, and was based upon [redacted] Similar conclusions were reached about the extremel important delay, deferred work and deterioration of labor items in the claims. These multi-million dollar items were, in theory, most easily susceptible to pressure from Willis or those above him. They were also the items in the claim that could be most easily inflated or distorted. Anyone wanting to defraud the government would find ample opportunities in the charts and cost calculations that are part and parcel of these items.* But no one took advantage of such opportunities. Finally, NNS told the Navy what its actual construction costs were and did not request reimbursement for work that was never performed or expected to be performe

What will be the impact of this failure of proof on a Bow Dome prosecution? In defense of Beauregard, counsel appears to be entitled to introduce evidence going to the integrity of the claims writing process. This evidence tends to negate any motive for inflating the Bow Dome item or going forward on an item without any colorable basis. Because the government will be unable to connect up the Bow Dome to any other structural items as part of a pattern or practice of deliberate misstatements of facts, the door will be left open for counsel to argue lack of motive and intent.

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*If one compares this investigation with the Litton prosecution, one notes that in Litton it was the delay claim with its platen loading and manpower curves that was the principal subject of fraud.

Because the defense can show that the Bow Dome had no effect on calculations of delay, disruption and deferred work in the claims, the defense will be able to prove that the presence or absence of the Bow Dome item did not materially affect the total amount of compensation proposed by NNS under the "Changes" Clause of the contract. The overall effect of such proof will negate any horizontal link to other structural items or any vertical link to the multi-million dollar claims for delay in the $210 million Proposal for Equitable Adjustment.

The jury may start thinking very practical thoughts like "Why would Beauregard try to rip the government off for $75,000.00 when he and other claims writers or editors passed up multi-million dollar opportunities for committing fraud?" It just doesn't make sense that on this item (where there is documentary proof of a disagreement) that Beauregard would take the chance of doing something fraudulent. Beauregard well knew and fully expected that the claim back-up files would eventually be made available during Rule 4 Discovery before the ASPCA. Any prosecution on this item is faced with a problem that the integrity of the rest of the claim and its millions of dollars of costs cannot be shaken. The better the rest of the claim looks, the more difficult a prosecutio on a small, isolated item in that claim becomes.

It is this writer's view that a defense based on the intregrit of the claims writing process and its costs calculations will survive a Motion In Limine. Such evidence is relevant* because the Bow Dome is associated with other structural items, the structu items are used as a predicate for the delay claim, and the delay claim is where most of the dollars are derived from for the entire Request for Equitable Adjustment. Moreover, the Navy repeatedly insisted during negotiations that the Bow Dome and all other individual items would not be treated as separate claims and would only be settled as part and parcel of the overall 688 proposal. The probable impact on the jury of proof going to the integrity of the entire claim should be considered in evaluating the prosecutive merits of a Bow Dome prosecution.

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* The problem is similar to attempts to exclude evidence regarding late government steel in any criminal case against Litton.

B. General Nature of the NNS Claims

Another general factor affecting the prosecution is the degree of Navy responsibility for added work, delays and disruption to nuclear ship construction. Most false claims cases involve subjects like double billing, phony work vouchers, the passing off of used parts for new, and the like. None of the NNS claims fall into this category. Of 63 items, only one seeks to blame the Navy for events that may not have occurred.* Typically, the facts in the claim are correct and the dispute is over whether or not the work in question is the Navy's contractual responsibility.

Early on in the claims effort key Navy officials acknowledged the Navy's responsibility for unilateral and late changes in design which caused millions of dollars of cost overruns on the 688 submarines. Wakefield and Admiral Gooding encouraged NNS to come in with a quick claim on the 688 submarine for design deficien These problems were to be handled by Wakefield's office and not by NAVSEA08.** NNS will probably be able to prove that a figure of $50 million dollars was talked about by both sides. The silent understanding was if the Navy came up with $50 million, the claims on the SSN 688 submarines would go away. Wakefield and Gooding hotly deny that they made any promise to pay NNS $50 million on the claims. [redacted]

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*The one exception is an item for added work on the platform on the SSN 688 submarine. NNS claims $300,000 for ripping out 216,000 pounds of steel. The Navy and some of the NNS employees believe that this rip-out work never occurred. Others, however, swear that they saw it happen and billed the Navy accordingly. Interview with Bridges and Ward establish that they had a good-faith basis for relying on eye-witnesses to the events and for including the item in the claim. [redacted]

**NAVSEA08 is Admiral Rickover's Department. Pursuant to implicit suggestions from Wakefield, NNS dropped many nuclear items from the claim to avoid tying up the settlement process in NAVSEA08's review procedures.

It is not hard to see how this type of evidence will create problems for the prosecution at trial. Defense attorneys will portray the Navy and the Department of Justice as one Government entity. They will argue or suggest that it is unfair to prosecute Virginia's largest employer for attempting to rip-off $75,000 when the government acknowledged five (5) years earlier that it owed the shipyard at least $50 million. And given that admission, the defense will argue that it is improbable that NNS would have tried to gain $75,000 at the risk of losing $50 million.

The defense attorneys could go one step further and prove at trial that the total amount of damages suffered by NNS because of late government information, late material and design inadequacies was well in excess of $100 million. All this evidence would be designed to show that NNS has never been paid the full amount of the damages it suffered as a result of Navy actions. One can also expect counsel to explore allegations of Navy misconduct in the handling of the claims and their settlement. Although the prosecution staff feels confident that evidence of this nature can be rebutted, substantial allegations will be made at trial that the Navy refused to pay NNS what it really owed them on the claims because of political interference and pressure from Admiral Rickove

All this evidence is designed to create great sympathy for the free world's largest shipyard. If they could get the evidence in, defense attorneys would try to link up the government's alleged misconduct in handling the claims with its "vindictive" prosecution and with its continued harrassment of the yard. A case in point might be the overhaul of the aircraft carrier Saratoga which went to Philadelphia instead of NNS despite GAO evidence that the boat could be overhauled for less at NNS.* Any opportunities to insinua that the government is taking a "cheap shot" at a great source of civic pride would not be overlooked.

Before one evaluates the probable success of a Motion In Limine with respect to much of this evidence, there are some basic facts that need to be considered. NNS builds excellent ships. The Navy is not involved here in a case of bribes, kick-backs or the substitution of shoddy goods for new parts. NNS built the submarines that are the subject of the claims and the subject of the fraud prosecution for approximately $50 million less per vessel than did the world's most famous submarine yard, Electric Boat in Groton, Connecticut. All the computer runs, documents and witnesses can never establish with any reasonable degree of certain that the Navy was not responsible for all of the cost overruns on the SSN 688 submarines. If permitted, counsel will be fully prepared to parade a series of horror stories before the jury on Navy foul-ups which impacted the construction of the submarines. The prosecution staff will then be faced with choice of: preparing at great time and expense to disprove evidence of tens of millions of dollars of Navy responsibility; or choosing to sit back, let it all go in, and then argue to the jury that such evidence is immater to proof of intent or motive to do wrong.

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*Although a motion to exclude this evidence would surely be granted similar allegations of harassment which can be linked with the settlement negotiations may not be so easily excluded.

It is unlikely that a Motion In Liminie will be granted except as to evidence unrelated to the construction contracts like the Saratoga controversy. However, evidence that NNS was promised a $50 million settlement is relevant to Beauregard's state of mind in 1975. He knew that the Navy was working towards a lump-sum settlement based on the many substantial design changes and their resulting delay and disruption to the ships. He also knew that NNS would never be paid dollar for dollar for an item like the Bow Dome. The claim that was submitted was simply a starting point for negotiations for an equitable adjustment of the entire contract. He knew that the final figure arrived at would have little or nothing to do with an individual item or its merits.*

Another argument in favor of admitting evidence of Navy responsibility for cost overruns can be based upon the Navy's attitude towards these claims. The Bow Dome is a separate item with its own narrative and pricing estimate in its own section of a fifteen (15) volume SSN 688 claim. The government will surely argue that as a separate line item, the only relevant evidence is that dealing directly with the sonar dome and the changes in attachment methodology. Beauregard will counter, however, with substantial evidence of Navy refusals to negotiate a line-by-line settlement of the claims. The Navy refused at all times to sit down with the contractor and tell the contractor how much each item was worth and negotiate separate settlements for each item. The Navy insisted that all the items be lumped together. The Navy insisted that the only figure that could be talked about was one lump sum figure based upon all the subsections and sections of the SSN 688 claims. Since Beauregard was aware that the Navy would only settle the entire claim, evidence of entitlement on other items cannot be excluded.

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*That type of argument can be turned the other way in favor of the prosecution. Because the Bow Dome was largely immaterial to a settlement, it was a tempting opportunity for Beauregard to overreac and submit something with no good faith legal basis to it. If the Navy later disagreed with the legal theory, nothing would be lost. The purpose of presenting various defense arguments here is not to imply that they are meritorious but to point out that a case can be made for the relevance of evidence of massive Navy Foul-ups in construction of the lead ship, the SSN 688. And if that evidence goes in, it is a factor to be considered in deciding to prosecute.

The last argument in favor of admitting general evidence regarding SSN 688 construction deals with the link between the Bow Dome and other claim items. As previously mentioned, the Bow Dome is one of eight structural items in the claim. These structural items are, in turn, used as one of the basic components for calculating delay. Delay is the largest element in the SSN 688 claim. Taking therir cue from earlier Navy analyisi and approaches to the SSN 688 claims, defense counsel can argue that the Bow Dome cannot be detached from a structure for which it is one of many building blocks.

On balance, any attacks by defense counsel at trial on Navy misconduct, government vindictiveness, Admiral Rickover, or the Navy procurement process will not be of great concern to the prosecution, even if such evidence is admitted. Admiral Rickover and his staff will not be easily cross examined and will be adept at doing the right amount of "flag waving" in defense of the public interest. Any diversionary attacks on the Navy or the prosecution can be expected to backfire if handled correct.

The more fundamental problem, however, is that the Navy is to blame for much of NNS' contractual overruns on the SSN 688 submarine The Bow Dome item, given its small monetary value and its technical nature, risks being drowned in a sea of evidence of Navy foul-ups, arbitrary actions, and unreasonablle delays. From day one of the SSN 688 contract, the Navy could not support the massive design, engineering and construction effort required by this new type of attack submarine. The jury, like the ASBCA in Litton, will be impressed with evidence that by imposing onerous contract conditions on the shipyard, the Navy "bought a law suit and the resulting claims." If counsel is successful at trial in creating an atmospher of charges and counter charges between the Navy and its principal defense contractor, the probable jury reaction will be to say "a plague upon both houses" and acquit.

C. Lack of Reliance on NNS' Representations

Proof of reliance is not a required element of the government's case. It always helps, however, to be able to show that there is a victim of the scheme to defraud. The jury in any NNS prosecution, will be dealing with a "victimless" crime. Because the Navy disagreed with Beauregard's legal analysis, it recommended that nothing be paid on the Bow Dome item. In fact zero entitlement was assigned to all of the items under active investigation by the prosecution staff. Nor did NNS press for payment. In fact, the contractor withdrew the Air Control item which is the subject of Ms. Adkins report. The shipyard also advised the Navy just prior to settlement in October, 1978, that the Bow Dome and Cathodic Protection were under review and were being substantially revised.

If called by the defense, the Navy technical analysts would state that little reliance was placed on the words or the numbers in the claims. The Navy expected the representations in the claims to change over time during the course of negotiations. The Navy collected enough paper down at the yard over the course of ship construction to conduct its own independent analysis of NNS entitlement for cost overruns.* The Navy told NNS that it would run its own analysis and would not necessarily rely on statements in the claim. In several instances, the Navy awarded entitlement to NNS based on facts and theories overlooked by NNS' own claim writers in putting together the request. All parties understood that the claims were not a firm or final document but simply a vehicle for the start of negotiations.

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*The Navy also had the benefit of a Booz-Allen study on productivity at the yard. Booz-Allen received cooperation from the shipyar in its study and obtained many internal shipyard documents. The 1,000,000 documents collected by the consultants were computerized and used by the Navy during its claims analysis. These materials, covering every phase of the shipbuilding process, were later turned over to the investigative staff.

No one at the Navy was misled by any statements in the claims. During the give and take of two years of negotiations, NNS voluntarily revised its claims several times to correct errors or omissions. NNS fully responded, although not always on time, to technical inquiries from the government. The general practice and policy was full disclosure of all facts in the hopes that some basis for equitable adjustment of the contract price could be found. One result of the flow of information between the Navy and the shipyard during claims negotiations was Bridge's letter of October 4, 1978. That letter provided information regarding the method of attachment in NNS' bid which had been omitted from the "Maxi" Bow Dome item because Beauregard considered it legally irrelevant. That was not the first time, however, that the Navy became aware of the information. The Navy received the bid estimat in 1970. The first thing the Navy analysts did in 1975 when they received the claim item was to look up the bid estimate and determi what method of attachment was used therein. And NNS can argue that full disclosure of the methodology was made in Volume IV of the claim which referenced the bid estimates. There was no need to reprint the bid in its entirety since the Navy already had it.

One can assess the impact of lack of proof of reliance by comparing the NNS claims with the typical false loan application case under 18 U.S.C. §1014. When the borrower comes in and represe that he owns 50 bulldozers worth $100,000 as collateral for a loan, the bank does not possess equal or superior information regarding the existence and worth of the collateral. Unless the bank takes affirmative steps to verify the authenticity of the title papers and to inspect the bulldozers, the bank has no way of knowing whether the debtor has $100,000 worth of collateral to pledge. Because the borrower has superior information, the law imposes a heavy penalty upon him if he knowingly makes a false statement or wilfully overvalues security for a loan under 18 U.S.C. §1014.

In the case of NNS, however, the government has substantially equal information regarding the history of construction of the vessel in question. Unlike the bank officer who has to make a loan decision on the basis of statements in the application, the Navy staff people did not place much reliance on what NNS said in its Request for Equitable Adjustment. No one expected and no one made the equivalent of a "loan" on the basis of what NNS said or did not say about its "collateral".

NNS told the Navy flat out in the claims that its request did not contain all of the facts relevant to a particular aspect of ship construction. NNS was not going to make the Navy's case for it and told the Navy that it was presenting only one side of the story. By way of response, the Navy repeatedly told NNS that it would do its own research and make its decisions on entitlement without regard to the claims.

Thus, as a practical matter, the requests were primarily used by both sides to identify those problem areas for which NNS wanted the contract target costs adjusted upwards. The claim was only a starting point for negotiations with each side doing its own research and coming up with its own theories of entitlement. Only after the research was completed was it understood that the Navy and NNS would sit down and see if they could resolve their differer regading contractual responsibility. Those discussions, like most aspects of the claims process, centered on legal, not factual issues.

Without question, the Request for Equitable Adjustment under the "changes" clause fits the technical definition of a claim under 18 U.S.C. §287. In practice, however, it was treated by the Navy as only an invitation to negotiate an adjustment in the profit and cost sharelines of the contract. The Admirals and did not consider either the dollar figures or the narratives to be firm representations of specific facts upon which Treasury funds could be expended. And when the time came for payment some two years after submission, no one at the Navy was misled as to material facts.

D. The Effect of Bridges October 4, 1978 Letter

The practical effect of Bridges' letter was to withdraw the item as submitted from the Proposal. [redacted]. Defense counsel will argue that reversal of Beauregard's legal position and advice is strong evidence of lack of intent to even be accused of violating 18 U.S.C. §287. A series of witnesses can and will be paraded before the jury to describe the numerous efforts made by NNS to correct errors in the claims and otherwise comply with the Truth-In-Negotiations Act. Other witnesses will detail the company's internal claims review process and its safeguards against fraud. This type of evidence is strong and hard to impeach.*

The more it apears that the company is law-abiding, the less likely it becomes that Beauregard had any incentive to defraud the government. Why would he act alone if his client was committed (in light of Admiral Rickover's warnings about fraud) to not cross the line between legal and illegal conduct? When the prosecution cannot identify any co-conspirators, there is no proof of a scheme to defraud. Defense counsel will argue that Beauregard had nothing to gain from an individual effort to rip-off the government; and risked losing his most lucrative client. Hence, the jury should believe his explanation of a good-faith legal basis for calling the bid data immaterial.

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*Consider Willis, for example. He may have been the master mind behind the claims his editing work, however, shows that he faithfull corrected any false statements that came to his attention.

VI. RECOMMENDATION

It is recommended that Beauregard not be prosecuted for the Bow Dome item. The claim, as corrected under his general supervisio contains only truthful statements. His legal reasons for omitting any comparison with the bid data are probably erroneous but are not clearly specious. The evidence surrounding preparation of the item and the 688 claim suggests lack of any intent to do something the law forbids. The nature of the claims, the lack of evidence of a general scheme to defraud, and the Navy's administration of the claims negotations process, all require that prosecutions be brought only where there is strong evidence of specific intent. This is not such a case.

JUSTIN W. WILLIAMS
UNITED STATES ATTORNEY

By: Eliot Norman
Eliot Norman
Assistant Untied States Attorney
Eastern District of Virginia
Richmond Division

OPTIONAL FORM NO. 10
JULY 1973 EDITION
GSA FPMR (41 CFR) 101-11.6
UNITED STATES GOVERNMENT

Memorandum

TO :Eliot Norman
Assistant United States Attorney

DATE:March 12, 1980

FROM :Saundra J. Adkins
Special United States Attorney

SUBJECT:Comments on Prosecutive Report--Bow Dome, SSN 688 Claim Item VII.B.8, Newport News Shipbuilding Procurement Fraud Investigation

These comments are intended to indicate my personal views of the matters addressed in subject report. At page eight(8) you indicate that Beauregard's rationale that bids are legally irrelevant rests largely upon the fact that the procurements were negotiated not competitive. I suggest that you footnote the fact that the first flight, (ships other than Hull 600) were bid, if that's the fact. As you know I have not delved deeply into the 688 facts, so I may be in error on this point.

At page 12 you state, "The Navy did not rely too much on the claim narrative or on the claim pricing in paying the Bow Dome or any other item." I do not agree. The Navy relied in that it investigated the facts alleged. The Navy did not rely only in the sense of not taking the claims at face value. Only in certain rare instances, including 688 delay and CGN 38 delay, did NCSB not rely on the claim. In those instances, NCSB indicated to NNS that it was doing an independent evaluation of liability for the general subject of Navy caused delay.

I concur with your general view that there is no false statement in the second Bow Dome claim. I find particularly persuasive the fact that the pricing proposal contained in the "Mini" was identical in the "Maxi" and that neither was based on a bid verses incurred comparison. I also think that Willis' position of good faith reliance on legal advice is probably a barrier we cannot overcome. Although I think Beauregard's legal advice as to relevance of bid/proposal is wrong, I do not on the facts developed see anyway to prove bad faith on Beauregard's part. Of course, if Willis, given immunity changes his story re Beauregard, then we may have something.

GOVERNMENT
EXHIBIT
1A

GRAND JURY MATERIAL
DO NOT DISCLOSE

Buy U.S. Savings Bonds Regularly on the Payroll Savings Plan

5010-110

Memo to Eliot Norman
March 12, 1980
Page 2

As to your general comments on failure of prosecutive theory I agree in substance. I probably would couch my opinion in less straight-forward language because I find it difficult after all these years to concede that there is no fire where there has been so much smoke. Nonetheless, I must concede that we have found no evidence (documentary or of witnesses) that the direction for amount to claim came from the top. I agree that we have thoroughly reviewed all documents that could be relevant and inquired of all witnesses who would probably know the facts. At this point I am faced with agreeing that no "grand conspiracy" existed or else agreeing that the stonewall cannot be overcome. In either event, we have virtually no chance of making a case against NNS or any corporate employees or officials other than Larry Doyle--see my prosecutive memo on CGN 38 VCAS.

I think you should point out that the small dollar value of some of the hardware items we have investigated would be immaterial if we had pretty clear evidence of fraudulent intent as to any or several of them.

I would add to your page 29 that claim narrative authors were put under considerable time constraint type pressure which could cause corner cutting.

A couple of nit picks arise out of my reading of the memo.

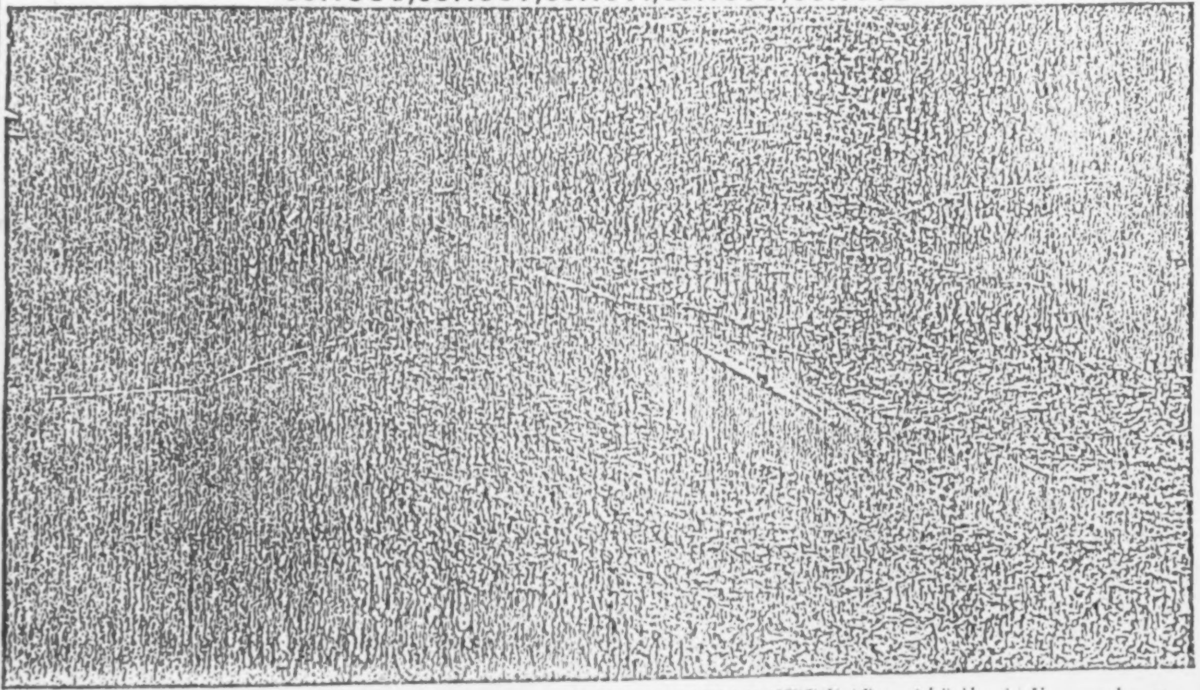
Second, I point out that somewhat contrary to your suggestion at page 45, NCSB found a very small amount of money due to NNS on account of its claims, less than the settlement amount that included $35 million for cost of litigation and $10 million under P.L. 85-809. I also disagree with your characterization at page 46 that both parties understood that the claims were not final but were simply a vehicle for negotiation. NCSB's investigation of the claims is analagous to discovery conducted after receipt of a complaint and the fact that there may result settlement negotiations in no way changes the finality of the complaint, which can of course be amended to avoid variance with later discovered facts. Along these same lines, I consider your statements at page 48 regarding Navy access to NNS records to be excessive. It is in fact surprising how little the Navy can learn given the presence of SOS in the shipyard. I would omit all but the concluding first paragraph of page 48.

I recommend that we give Willis immunity and have him put into the records answers regarding Bow Dome that he has made off the record. Then we can be as sure as legal process allows of the accuracy of our findings.

cc: Eugene B. Paulisch
Special United States Attorney

MANAGEMENT SUMMARY

PROPOSAL FOR EQUITABLE ADJUSTMENT OF
CONTRACTS N00024-70-C-0269 AND N00024-71-C-0270
SSN688,SSN689,SSN691,SSN693,SSN695



Newport News Shipbuilding
A Tenneco Company

TENNECO

PROSECUTIVE REPORT--BOW DOME, SSN 688 CLAIM ITEM VII.B.8
NEWPORT NEWS SHIPBUILDING PROCUREMENT FRAUD INVESTIGATION

SUPPLEMENTAL EXHIBIT

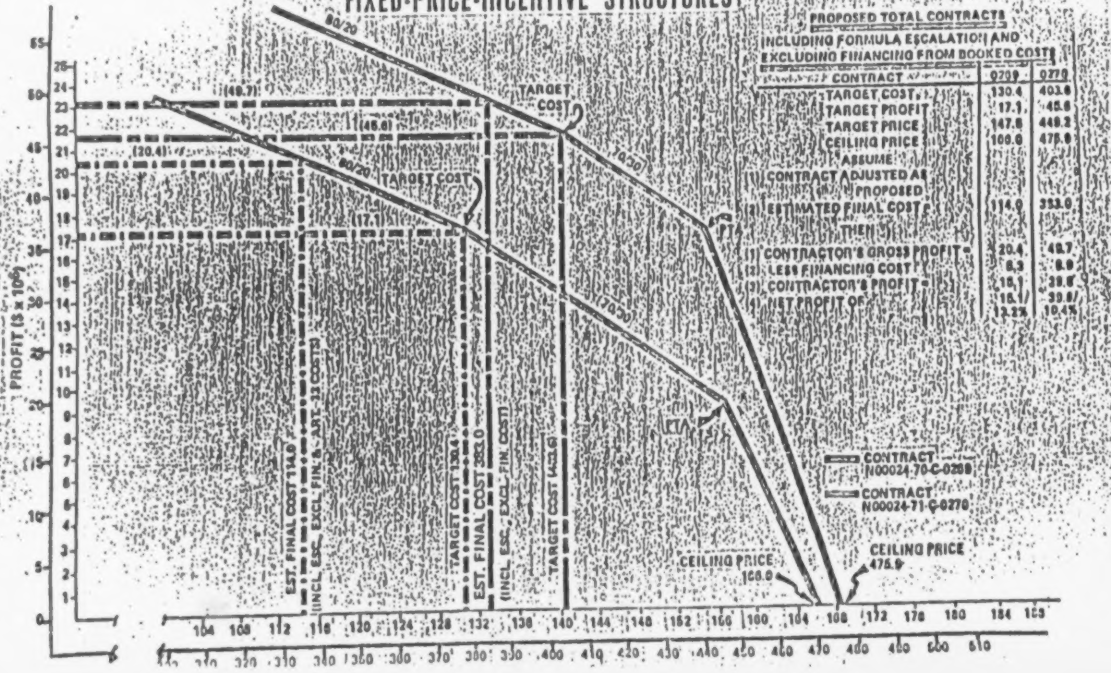
GRAND JURY MATERIAL
DO NOT DISCLOSE

EXHIBIT
1B

RECAPITULATION OF PROPOSED TARGET COST INCREASES

COST CATEGORY	N00024-70-C-0269 SSN 688	N00024-71-C-0270 SSN689, SSN691 SSN693, SSN695	TOTAL BOTH CONTRACTS
STRUCTURE	$ 2,486,626	$ 2,010,924	$ 4,497,550
SHIELDING	508,558	1,853,855	2,362,413
PIPING	4,815,446	9,370,073	14,185,519
MACHINERY	1,123,786	3,340,079	4,463,865
ELECTRICAL	201,122	130,086	331,208
DELAY	26,125,826	83,062,902	109,188,728
ACCELERATION	3,751,269	868,019	4,619,288
DISRUPTION	9,248,394	15,297,757	24,546,151
FINANCING	5,342,130	9,921,099	15,263,229
OTHER	4,576,953	16,046,834	20,623,787
TOTAL	$ 58,180,110	$ 141,901,628	$ 200,081,738

CONTRACTS N00024-70-C-0269 & N00024-71-C-0270 FIXED-PRICE-INCENTIVE STRUCTURES



PROPOSED TOTAL CONTRACTS

INCLUDING FORMULA ESCALATION AND EXCLUDING FINANCING FROM BOOKED COSTS

CONTRACT	0269	0270
TARGET COST	130.4	403.6
TARGET PROFIT	17.1	45.6
TARGET PRICE	147.5	449.2
CEILING PRICE	160.0	475.9
ASSUME		
(1) CONTRACT ADJUSTED AS PROPOSED		
(2) ESTIMATED FINAL COST	114.0	383.0
THEN		
(1) CONTRACTOR'S GROSS PROFIT =	20.4	42.7
(2) LESS FINANCING COST	6.3	2.9
(3) CONTRACTOR'S PROFIT =	14.1	39.8
(4) NET PROFIT OF	14.1/ 12.2%	39.8/ 10.4%

EFFECT OF THE PROPOSAL

- THE FEATURES OF A FIXED-PRICE-INCENTIVE-FEE CONTRACT OPERATE TO PROTECT THE GOVERNMENT. NO MATTER HOW HIGH THE TARGETS AND CEILING ARE SET, WE WILL NOT BE PAID MORE THAN THE SUM OF (1) ACTUAL ALLOWABLE COSTS CHARGED TO THE CONTRACT, AND (2) AN ALLOWANCE FOR PROFIT.

- THE CONTRACT PROVIDES FOR ADJUSTMENTS FOR ESCALATION. FOR EASE FOR ANALYSIS, ESCALATION IS ADDED TO THE PRICE IN THE CHART ABOVE, AND IT IS INCLUDED IN THE BOOKED COSTS SO IT DOES NOT CHANGE THE OUTCOME.

- IN THE PROPOSAL PROPER, WE DEVELOPED A THEORETICAL PROFIT PERCENTAGE USING THE WEIGHTED GUIDELINES METHOD SET FORTH IN THE ARMED SERVICED PROCUREMENT REGULATIONS (ASPR). OUR USE OF THE METHOD IS EXPLAINED IN THE PROPOSAL, AND WE FOUND THAT ASPR GUIDELINES WOULD SUPPORT A PROFIT OF MORE THAN 16 PERCENT FOR PRICING A CONTRACT ADJUSTMENT SUCH AS THIS.

- THE ANALYSIS PRESENTED THERE SHOWS WHAT WOULD HAPPEN IF: (1) THE NAVY WERE TO ACCEPT OUR PROPOSED INCREASED TARGET COSTS IN THEIR ENTIRETY: (2) THE PROPOSED TARGET PROFITS OF $17,100,000 AND $45,600,000 FOR N00024-70-C-0269 AND N00024-71-C-0270, RESPECTIVELY, WERE UNCHANGED: AND (3) WE ARE ABLE TO COMPLETE THE CONTRACTS FOR $114,000,000 AND $383,000,000 (EXCLUDING $5,300,000 AND $9,900,000 FINANCING COSTS) AS NOW ESTIMATED. IN SUCH CASE, WE WOULD ACHIEVE ABOUT 13.2 AND 10.4 PERCENT PROFIT AFTER CONSIDERATIONS FOR FINANCING OF THE ACTUAL COSTS FOR EACH CONTRACT. THESE CALCULATIONS ASSUME THAT ALL COSTS ON THE BOOKS WILL BE ALLOWED.

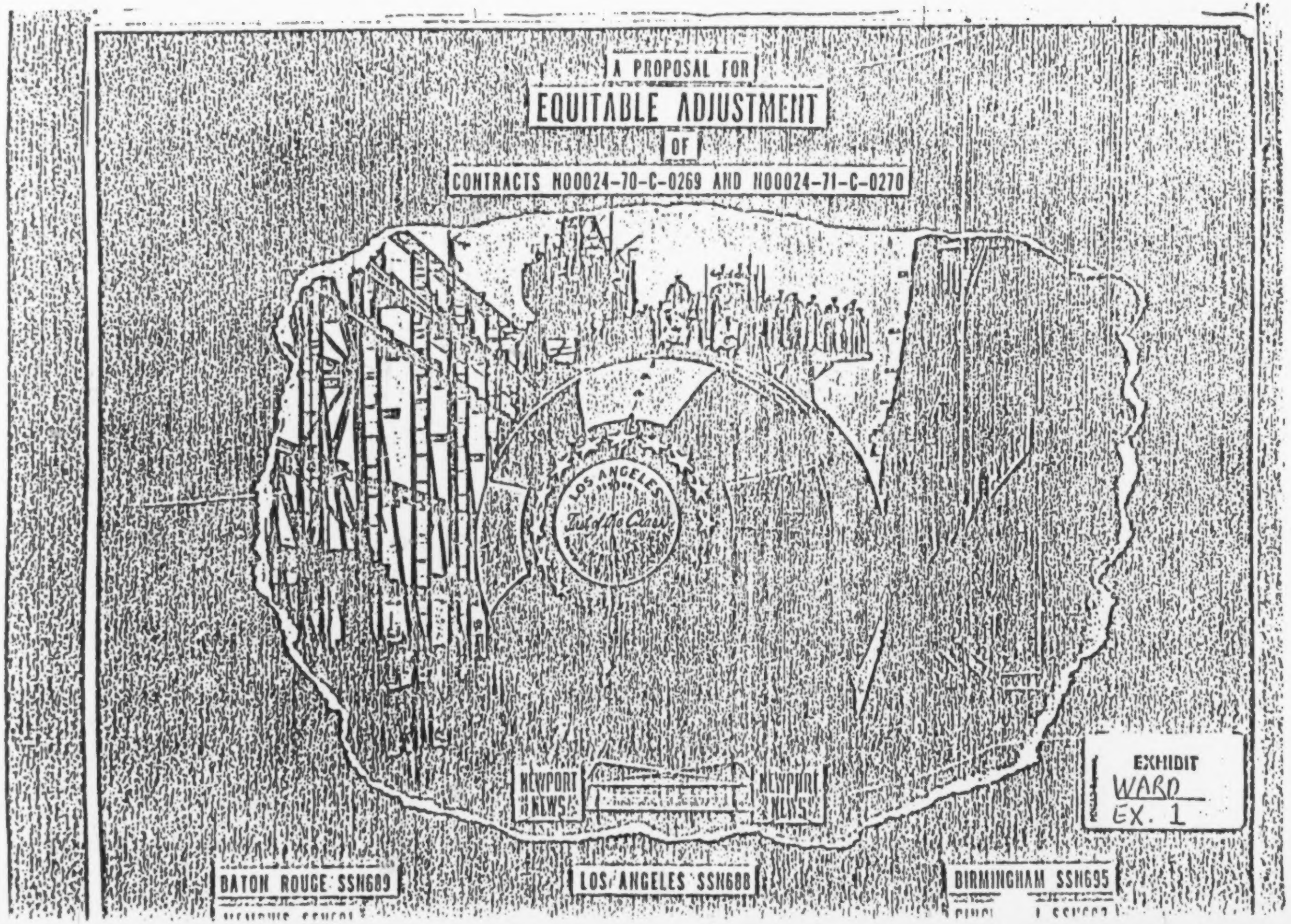
SECUTIVE REPORT - BOW DOME ITEM, 688 C

TABLE OF EXHIBITS

DOCUMENT	DESCRIPTION	REFERENCE(S) IN REPORT
Ward EX. 1	Photograph showing the GRP Bow Dome as a "nose cone" of the SSN 688 sitting in dock.	P. 1
Ward EX. 7	Pricing Details and Cost Estimate dated August 8, 1975, from the Maxi claim for the GRP Bow Dome item.	P. 9
Ward EX. 8	Cost Estimate for the Bow Dome Item as supplied in NNS' "mini" claim, dated 21 January 1975.	P. 3,4
Ward EX. 9	"Mini" claim narrative for the Bow Dome, submitted June 2, 1975 to the Navy.	P. 3
Ward EX. 16	Diagram showing the simplified structure of an SSN 688-class submarine. The sonar tip in the diagram sumbolizes the position and function of the GRP Bow Dome.	P. 1
NNS 281, pp. 68-70	Willis' progress report to Creech, dated August 12, 1975, detailing reasons for reinstating the Bow Dome item.	P. 8,9
NNS 281, pp. 73	Ward's Weekly Progress Report sent to Willis, dated August 12, 1975. The memo stated that the GRP Bow Dome and Cathodic Protection items had been reinstated in the "Omnibus" proposal.	P. 8
NNS 341, pp. 7	Government Working Drawing (1290-6) redesigning the bow dome connection method to bolting from welding.	P. 3
NNS 341, pp. 25-26	Inter-office memo from Covington to Adams, dated February 10, 1978 outlining the facts related to Bow Dome attachment.	PP. 10, 12, 13, 16
NNS 341, pp. 30, 4	Contract Guidance Drawing (800-4385833) showing welding as the method of attachment for the GRP Bow Dome	P. 2
NNS 341, pp. 31-34	Memo from Davis, dated April 27, 1970, recommending bolted attachment as studied at Mare Island, California. Page 34 shows Davis' sketch of bolted connection	P. 5
NNS 341, p. 36	The GRP Bow Dome entitlement narrative in the "Maxi" claim, submitted to the Navy on 6 March 1976.	P. 10

EXHIBIT
1C

DOCUMENT	DESCRIPTION	REFERENCE(S) IN REPORT
NNS 341, pg. 38	Beauregard's comment on the GRP Bow Dome item in the course of his mini/maxi comparison beginning in April of 1976.	P. 11, 16
NNS 341, pp. 43-44	Draft of the GRP Bow Dome item entitlement narrative for the "maxi" claim with Willis' revisions.	P. 10
NNS 341, pp. 84	Memo dated November 22, 1974 from Zelle in the Hull Structural Design Department explaining the departure from the connection method called for in the Contract Guidance drawing. Bolt relied on this memo in writing the claim.	P. 5, 12
NNS 341, p. 94 (Also Ward EX. 18)	Handwritten note dated July 22, 1975, by Ward in the Bow Dome Back-up Folder showing that bolting was included in the original bid. It also records agreement to drop the item from the "maxi" claim.	P. 6, 7,
NNS 538, pp. 3-4	Bridges' letter submitted to the Navy on October 4, 1978, which provided supplemental information on the Bow Dome claim.	P. 13
NNS 960 pp. 5-8	Pages from the SSN 688-class Bid Estimate dated May 16, 1970 making reference to Davis' "mare Island" memo which had suggested the improved bolting method.	P. 5
NNS 960, p. 13	Handwritten memo, dated August 8, 1975, from Cost Enginnering explaining why "no credit" was given in the estimate.	P. 3
NNS 960, p. 21	Pricing details worksheet dated 15 and 22 July 1975 with a note to Cost Engineers, in effect, to disregard previous instructions and to submit estimates for the GRP Bow Dome item.	P. 9



A PROPOSAL FOR

EQUITABLE ADJUSTMENT

OF

CONTRACTS N00024-70-C-0269 AND N00024-71-C-0270

NEWPORT NEWS
NEWPORT NEWS

EXHIBIT
WARD
EX. 1

BATON ROUGE SSN689

LOS ANGELES SSN688

BIRMINGHAM SSN695

ESTIMATE OF COST
NEWPORT NEWS SHIPBUILDING & DRY DOCK COMPANY
NN 3778

HULL NO. 600
FILE

FOR VII.B.8 GLASS REINFORCED PLASTIC BOW DOME

DRAWING NO.
LETTER NO.

ITEM	QUAN.	WEIGHT		MATERIAL		MANHOURS		LABOR		TOTAL COST
		ROUGH	FINISHED	UNIT	COST	UNIT	TOTAL	UNIT	COST	
ATTACH THE GRP DOME TO THE HULL WITH BOLTS IN LIEU OF WELDING										
(1) MATERIAL FOR ATTACHMENT OF GRP DOME TO HULL										
(a) SHOULDER BOLTS	192			17.39	3339				P.O. 600-	1.9997-H2
(b) NUTS	192			6.84	1313				PO. 600-1	.9999-H3
(c) WASHERS	192			2.35	451				PO 600-1	9999-H1
(d) DOWEL PINS	5			(EST)	142	12	60	(EST)		
(e) LABEL PLATES	6		(EST)	2.00	12	2	12			
(2) DRILL & REAM HOLES IN THE GRP DOME ATTACHMENT RING AND THE HULL FDN RING — INSTALL BOLTS, WASHERS AND NUTS AND TORQUE TO APPROXIMATELY 1000 FT LB	192				—	(EST) 24 1/2	4608			
MISC CONSUMABLE STORES			(EST)	25%	1357					
TOTAL					6,614		4,680			
ENGINEERING:										
100 MHS (EST)										

EXHIBIT
WARD
7X-#7

REMARKS

U.D.P.

COMPUTED BY
CHECKED BY
APPROVED J.C.

IX-91

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901-16
  AUGUST 11,1975

          DESCRIPTION                                                        COST
                                                                             ELEMEN
               VII.3.8.      Glass Reinforced Plastic Bow Dome               #47

   PRODUCTION HOURS                                                          468
   SUPERVISION HOURS                                                          88
   G & S HOURS                                                               131
   ENGINEERING HOURS                                                          10

   TOTAL PRODUCTION LABOR                                                    215
   TOTAL SUPERVISION LABOR                                                    55
   TOTAL G & S LABOR                                                          60
   TOTAL ENGINEERING LABOR                                                     6
                                                                          --------
   TOTAL LABOR DOLLARS (LESS PREM.)                                 $        337

   MATERIAL (PROD.)                                                 $         66
   MATERIAL (G&S)                                                             15
                                                                          --------
   TOTAL MATERIAL                                                   $         81

   TOTAL PRODUCTION PREMIUM                                         $         22
   TOTAL SUPERVISION PREMIUM                                                   3
   TOTAL ENGINEERING PREMIUM
                                                                          --------
   TOTAL PREMIUM LABOR                                              $         25

   OVERHEAD                                                         $        302
   OVERHEAD ADJUSTMENT
                                                                          --------
   TOTAL OVERHEAD                                                   $        302
                                                                          --------
   TOTAL COST                                                       $         74
                                                                          ========

   PROD LABOR RATE ($ PER HOUR)                                              4.6
   SUPV LABOR RATE ($ PER HOUR)                                              6.2
   ENGR LABOR RATE ($ PER HOUR)                                              6.C
   SUPV PERCENTAGE                                                            .1
   G&S LABOR PERCENTAGE                                                       .2
   G&S MATL  PERCENTAGE                                                       .0
   OVERHEAD PERCENTAGE                                                        .8
   OVERHEAD ADJUSTMENT ($ PER HOUR)
   PROD PREMIUM PERCENTAGE                                                    .C
   SUPV PREMIUM PERCENTAGE                                                    .C
   ENGR PREMIUM PERCENTAGE                                                    .C
                                                                          =======
```

VI. B.8 GLASS REINFORCED PLASTIC BOW DOME

DRAWING NO.

LETTER NO.

ITEM	QUAN.	WEIGHT		MATERIAL		MANHOURS		LABOR		TOTAL COST
		ROUGH	FINISHED	UNIT	COST	UNIT	TOTAL	UNIT	COST	
ATTACH THE GRP. DOME TO THE HULL WITH BOLTS IN LIEU OF WELDING										
1) FABRICATE SHOULDER BOLTS, WASHERS & SELF-LOCKING NUTS FOR ATTACHMENT OF GRP DOME TO HULL	192			20/EA	3840	12/EA	2304			
2) DRILL AND REAM HOLES IN THE GRP DOME ATTACHMENT RING AND THE HULL FDN RING — INSTALL BOLTS, WASHERS AND NUTS AND TORQUE TO APPROXIMATELY 1000 FT-LB.	192				—	24/EA	4608			
MISC. CONSUMABLE MAT'L				20/EA	1382					
TOTAL					5222		6912			
ENGR. USE					5200		6900			
100 M/H										

EXHIBIT
WARD
Ex 8

REMARKS

COMPUTED BY	CHECKED BY	APPROVED BY
CDR 1/10/75	RCH 1/21/75	

(72)

(1/21)

WARD EX. 8.

4

he ship that would normally be completed in the shops. The late issue and erous alterations to the drawings caused a considerable amount of rework of d damping and insulation. Therefore, the Contractor requests equitable ustment for these increased costs. Pricing details are in Section V.

.3.8. Glass Reinforced Plastic Bow Dome

The configuration and connection method for the glass-reinforced stic bow dome, SSN688, was shown on Contract Guidance Drawing 800-4385833 nished by the Government for bidding purposes. This Contract Guidance wing was used by the Contractor in the preparation of the estimate for ting and connecting the bow dome to the ship's hull. The Contractor had the ht to assume that the information shown on this drawing was representative he Government's requirements and provided reasonable guidance for the paration of a sound estimate.

The Contract Guidance Drawing 800-4385833 showed the attachment for e glass-reinforced plastic bow dome connected to the hull by welding. The vy later discovered that the welded connection was impractical due to the weld istortion which occurred during installation by this method.

The Government Design Agent issued Drawing No. 1290-6, "Hull tachment Ring, Glass Reinforced Plastic Bow Dome" which redesigned the bow me connection to provide for a bolted connection. This redesign utilized 2 1-5/8 inch diameter K-Monel shoulder fasteners to attach the dome to the ll. This radical departure from the Contract Guidance Drawing resulted in ditional labor and material requirements for which the Contractor is led to reimbursement. The redesign necessitated the drilling of holes, aming, and torqueing of the fasteners in accordance with the stringent ecification requirements. The welding effort was not reduced by the change the attachment method, since the attachment became a built-up angle that quired welding in way of the flanges.

EXHIBIT
WARD
EX#9

WARD EX. 9

This change in design/specifications was made subsequent to Contractor preparation of his bid, and could not have been contemplated by the Contractor. This change has resulted in added costs to the Contractor, for which he is entitled to an equitable adjustment. The pricing details are included in Section V.

III.B.9 Cathodic Protection

The original estimate for cathodic protection (hull zincs) for SSN688 was based on the requirements of submarines previously built by the Contractor because the specifications were essentially unchanged.

As the design of the SSN688 developed, the requirements for hull zinc increased significantly over the Contractor's interpretation. The quantity of zincs increased approximately 20 percent and installation manhours increased about 300 percent. The marked increase in installation manhours resulted from the different methods of attachment of the zinc anodes to the hull. In accordance with the applicable drawings, installation on SSN688 required the installation of studs which had to be jig set, shot welded, cleaned, and painted before the zincs could be installed on rubber grommets and bolted. This multi-step method increased manhour requirements approximately 300 percent in comparison to methods used previously.

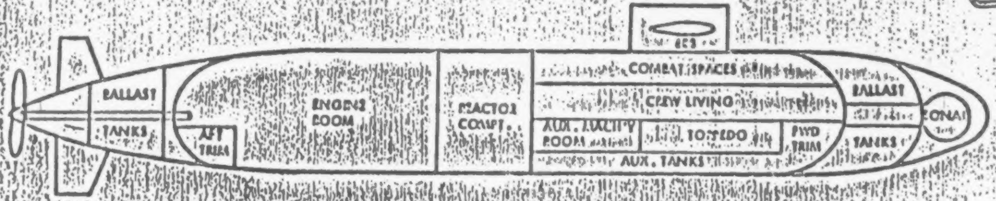
The Contractor is entitled to reimbursement for the additional costs resulting from the increased design requirements for zinc anodes and the change in installation methods. This entitles the Contractor to reimbursement for the added costs that were incurred in order to comply with the ship drawings as finally developed by the Design Agent.

6

Section II

INBOARD PROFILE

EXHIBIT
WARD
EX 16


BALLAST
TANKS
AFT TRIM
ENGINE ROOM
REACTOR COMPT.
COMBAT SPACES
CREW LIVING
AUX. MACH'Y ROOM
TORPEDO
AUX. TANKS
FWD TRIM
BALLAST
TANKS
SONA

Ward EX.16

7

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NEWPORT NEWS SHIPBUILDING AND DRY DOCK COMPANY

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FILE NO.__________

NEWPORT NEWS, VIRGINIA

August 12, 1975

MEMORANDUM For Mr. F. H. Creech

Subject: Progress Report

Enclosures:
(1)-(5); Progress Reports for the Week-Ending August 8, 1975
(1) E. M. Alexander - DLGN36 and DLGN38 Classes
(2) T. C. Chandler - CVAN68 Class
(3) R. D. Ward - SSN688 Class
(4) N. B. Baffer - MARF - Submarine Overhauls/Security
(5) R. B. Terrell - Manpower - All Ships and Programs

During the past week, the Proposal for Equitable Adjustment of the DLGN38 Class contract was submitted. Eleven copies of the complete proposal have been provided to the Government, including one copy for DCAA. The number of copies was determined by the Government, and it should be sufficient for all their foreseeable needs. This matter will be dropped from the report until further significant actio is taken. The proposed increases in the contract pricing structure were:

Target Cost	$120,366,835
Target Profit	$ 19,695,812
Target Price	$140,062,647
Ceiling Price	$159,774,936

Action by SupShip continued last week on the previously submitted Proposa for Equitable Adjustment of the contract for DLGN36 and 37. Additional material in both the nuclear and non-nuclear areas was provided, and we are attempting to help t SupShip people develop ways to streamline their analysis effort. Additionally, we have provided data to the Supervisor for all Acceptance Trial Items for DLGN36 show that the Company is not responsible for more than a handful of such items. The remaining open item on DLGN36 is Quality Deficiency Reports for which the Navy alle that credit is due. To date, we have not discovered any items of real significance where the Navy is entitled to a price reduction. Some of the Quality Deficiency Reports may be troublesome, but the "several million dollars" in counterclaims whic the Navy has mentioned remains unknown to us.

Progress on the CVAN68 Class Proposal improved during the last week. The principal problem area is the delay of CVAN69. Our computer analysis needs strengthening, and we are doing everything to get it fully developed. Supporting material for a proposed delay because of the change on Main Coolant Stop Valves was sent to SupShip last week. A revised pricing proposal will follow shortly.

EXHIBIT
NNS 281
pp. 68-70

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NS 281

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the Newport News Shipbuilding and Dry Dock Company

MEMO TO: Mr. F. H. Creech

August 12, 1975

The combined proposal for all known 688 Class matters is being reviewed b Mr. Beauregard. In the current draft two items which were included in the design and data proposal were omitted because further study indicated that they might have been picked up as increased cost items prior to or during contract negotiations. Upon a comprehensive reanalysis of the contract requirements for these items as opp to the installation required by lead yard drawings, we found that both items should reinstated. They are the Glass Reinforced Plastic Bow Dome and Cathodic Protectio Mr. Beauregard's review is progressing well, and no major redirections have thus fa been indicated. We continue to receive questions from DCAA concerning the proposal design and data problems on the SSN688 Class. No significant problems have been uncovered as a result of such questions.

The final draft of the MARF Proposal is complete. This draft incorporate all comments received from the several prior reviews, including Mr. Dart, Mr. Runey and the Cost Engineers. Mr. Beauregard has completed his final review of the propo and Management Summary. A management review is being scheduled for August 14, 1975 with the objective of submitting the proposal to KAPL by August 16, 1975.

Significant events in the submarine overhaul program included:

1. SSBN616 – A tentative settlement of the SSBN616 proposal submitted in 1970 had been reached, with disposition of our request for financing costs being reserved for a later time. We learned yesterday that the Navy negotiator is apparently being overruled by his lawyers, and the Navy will ask us to agree to waive all further claims.

2. SSBN617 – We have provided additional material to the Navy which may enable them to develop a negotiation position on our December 1974 proposal. Our extensive PERT analysis of the 617 effort is also continuing as a backup.

3. SSBN624 – A Proposal for Equitable Adjustment will have to be developed covering delays on this ship which may exceed six months. To date, some two months of this delay may be attributable to formal changes with the rest of the delay being controlled by the fact that work could not be started as planned because the SSBN617 could not be completed as scheduled.

Work is now underway to develop proposals for equitable adjustment of the commercial ship construction contracts. We may be able to show that our costs were increased because the Coast Guard insisted on reinterpretations of existing regula Other cost increases may be explained by changes in law which may entitle us to an equitable adjustment, or excusable delay, or both. Actions by the owner which caus increased cost may also account for part of our problems. Initial efforts will be concentrated on developing proposals for mutual adjustment of contract timetables and other requirements so as to avoid disputes and litigations.

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9

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e Newport News Shipbuilding and Dry Dock pany

MEMO TO: Mr. F. H. Creech

August 12, 1975

A composite picture of our utilization of manpower for the past decade is just about finished. The first draft will certainly require much work, but it appears that we will be able to show that actions taken in the 1964-74 period were reasonable and proper under the circumstances involved. Further, we expect to show that the Navy knew, or should have known, that its actions and inactions would affect all of the Company's business. The portions of the ship proposals relating to Navy Recruiting Practices will be included in this analysis.

Additional details on specific items are contained in the attached reports.

CLWillis
C. L. Willis
Director of Contract Controls

CLW:dmw

Copies:
C. E. Dart
B. F. Bridges
N. B. Baffer
T. V. Brabrand
L. M. Doyle
R. B. Terrell
J. E. Arthur
E. M. Alexander
T. C. Chandler
J. O. Dynes
T. R. Kelpin
J. C. Meredith
R. D. Ward
C. L. Willis

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10

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NEWPORT NEWS SHIPBUILDING AND DRY DOCK COMPANY

FILE NO.________________

NEWPORT NEWS, VIRGINIA

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August 12, 1975

MEMORANDUM For: Mr. C. L. Willis

Subject: SSN688 Class; Weekly Progress Report

The typing of chronology for the SSN688 Class Proposal, "omnibus" version remained a problem throughout last week. The final corrections and pagination were made Monday, August 11, 1975 and forwarded to reproduction for off-setting.

The pricing details for the "omnibus" proposal should be complete later this week as stated in my last report.

Two items of entitlement, which I had removed from this proposal will now be inserted per your direction. The items are the Glass Reinforced Plastic Bow Dome and Cathodic Protection, Sections VII.B.8 and VII.B.9, respectively.

The DCAA is continuing to ask questions on the SSN688 Proposal submitted June 2, 1975. Answers to several questions have been delayed as a result of trying to meet deadlines in preparing the "omnibus" proposal. It is anticipated that most questions will be answered this week.

R. D. Ward

R. D. Ward
Contract Administrator,
SSN688 Class Submarines

RDW:jaj
Copies
Mr. B. F. Bridges
File

EXHIBIT
NNS28
D. 73

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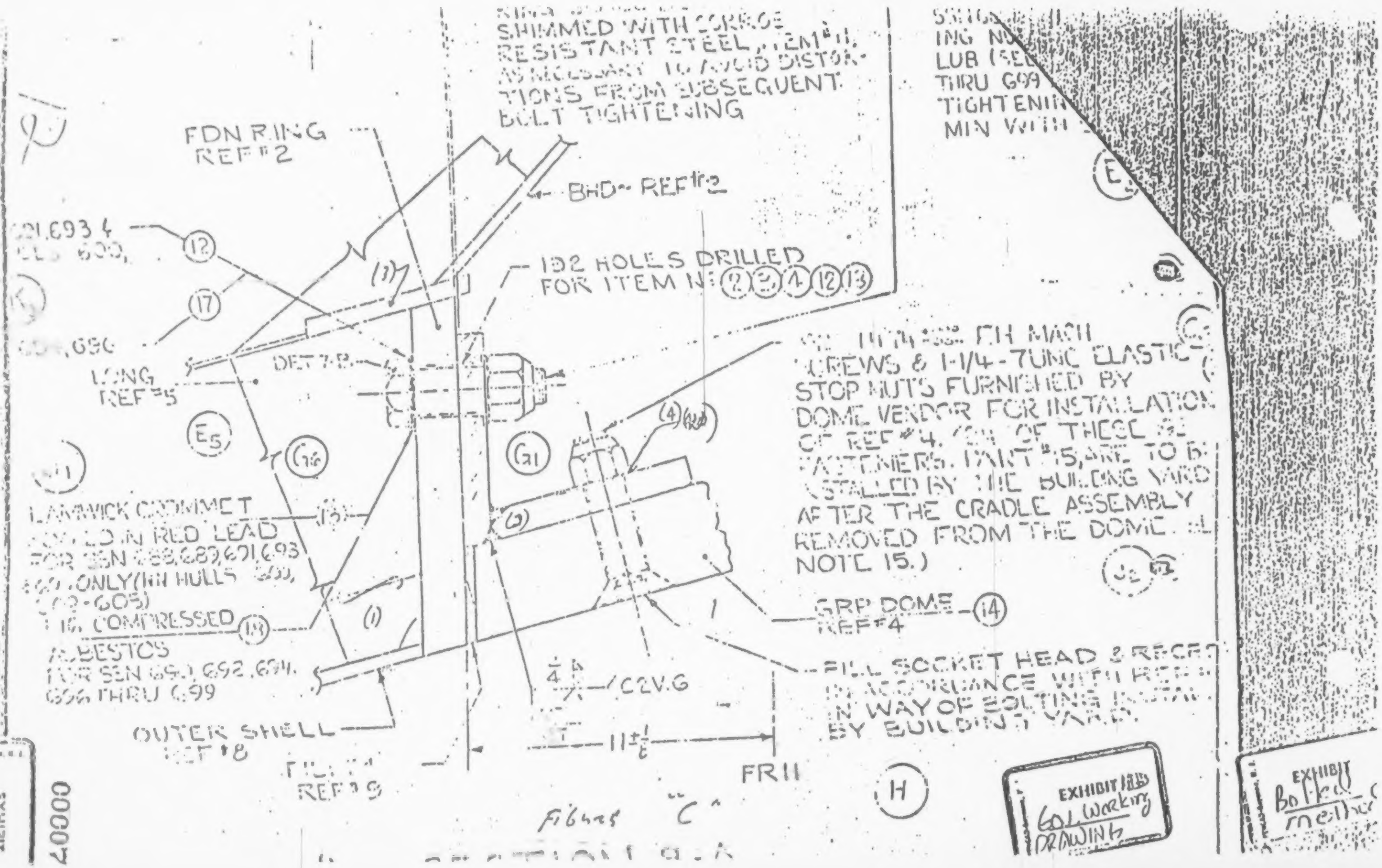

SHIMMED WITH CORROS
RESISTANT STEEL, ITEM 11,
AS NECESSARY TO AVOID DISTOR-
TIONS FROM SUBSEQUENT
BOLT TIGHTENING
ING
LUB
THRU 699
TIGHTENI
MIN WITH
FDN RING
REF#2
BHD REF#2
693 4
12
17
696
(17)
LONG
REF#5
DET 7-B
E5
G16
G1
E
C
J2
132 HOLES DRILLED
FOR ITEM N (2)(3)(4)(12)(13)
FH MACH
SCREWS & 1-1/4-7UNC ELASTIC
STOP NUTS FURNISHED BY
DOME VENDOR FOR INSTALLATION
OF REF#4. OF THESE
FASTENERS, PART #15, ARE TO BE
INSTALLED BY THE BUILDING YARD
AFTER THE CRADLE ASSEMBLY
REMOVED FROM THE DOME.
NOTE 15.)
(4)
(3)
(1)
LAMMICK GROMMET
IN RED LEAD
FOR SSN 688,689,671,693
ONLY(IN HULLS
-605)
13
COMPRESSED
ASBESTOS
FOR SSN 690,692,694,
696 THRU 699
18
OUTER SHELL
REF#8
REF#9
GRP DOME
REF#4
14
FILL SOCKET HEAD & RECE
IN ACCORDANCE WITH REF
IN WAY OF BOLTING INSTAL
BY BUILDING YARD.
C2V.G
11 1/8
FR 11
H
Figure "C"

EXHIBIT 18B
GOL Working
DRAWING

EXHIBIT
Bolting
method

EXHIBIT
JMS 391

[illegible] Valid [illegible]

NN 23 (3121120)

INTER-OFFICE COMMUNICATION

NEWPORT NEWS SHIPBUILDING AND DRY DOCK COMPANY

A Tenneco Company

[illegible]

TO: E. B. Adams, Jr.

FILE NO. [illegible]

DATE February 10, 19

FOR: Information

FROM: Manager of Cost Engineering

SUBJECT: Glass Reinforced Plastic Bow Dome for 688 Class Submarines

Reference:
(a) Your Oral Request Relative to This Subject on February 9, 1978

Enclosures:
(1) Contract Guidance Drawing - NAVSHIPS Drawing No. 800-4385833 dated January 29, 1970
(2) O. E. Davis' Memorandum for File Relative to This Subject dated December 22, 1969
(3) O. E. Davis' Memorandum for File Relative to This Subject dated April 27, 1970
(4) Original Proposal Estimate for the Subject Work dated May 19, 1970
(5) Entitlement Section No. VII.B.8 of our Request for Equitable Adjustmen Relative to This Subject
(6) Cost Estimate for Entitlement Section No. VII.B.8 Relative to This Subject dated August 8, 1975

Enclosures (1), (2), (3), (4), (5) and (6) are submitted herewith in response to reference (a). A synopsis of events relevant to this subject is pre as follows:

1. Enclosure (1) provided for a welded flat bar ring as a connector between ship's structure and the glass reinforced plastic bow dome as noted in panel 2C.

2. Enclosure (2) provided a sketch that indicated a welded flat bar ring attachment method as noted in enclosure (1).

3. Enclosure (3) noted difficulty of dome installation at Mare Isla Naval Shipyard when a welded flat bar attachment was utilized and suggested a bolted structural angle ring dome attachment method as noted in a sketch attached to this enclosure.

4. Enclosure (4) incorporated the bolted structural angle ring dome attachment method as the basis for the Company's cost estimate relative to this subject (note deviation from enclosure (1) was included in basic proposal).

[illegible] cost of [illegible]

MEMO TO: E. B. Adams, Jr. February 10, 1978

5. The SSN688 Contract was signed on March 26, 1971, with definitization date retroactive to January 8, 1971.

6. The Design Agent obtained Navy approval and submitted Drawing No. 1290-6 relative to this subject on June 28, 1971. This drawing indicated the bolted structural attachement method.

7. Enclosure (5) provided an entitlement and an estimating scope outlining the difference between enclosure (1) and N.N. Drawing No. 1290-6 noted above.

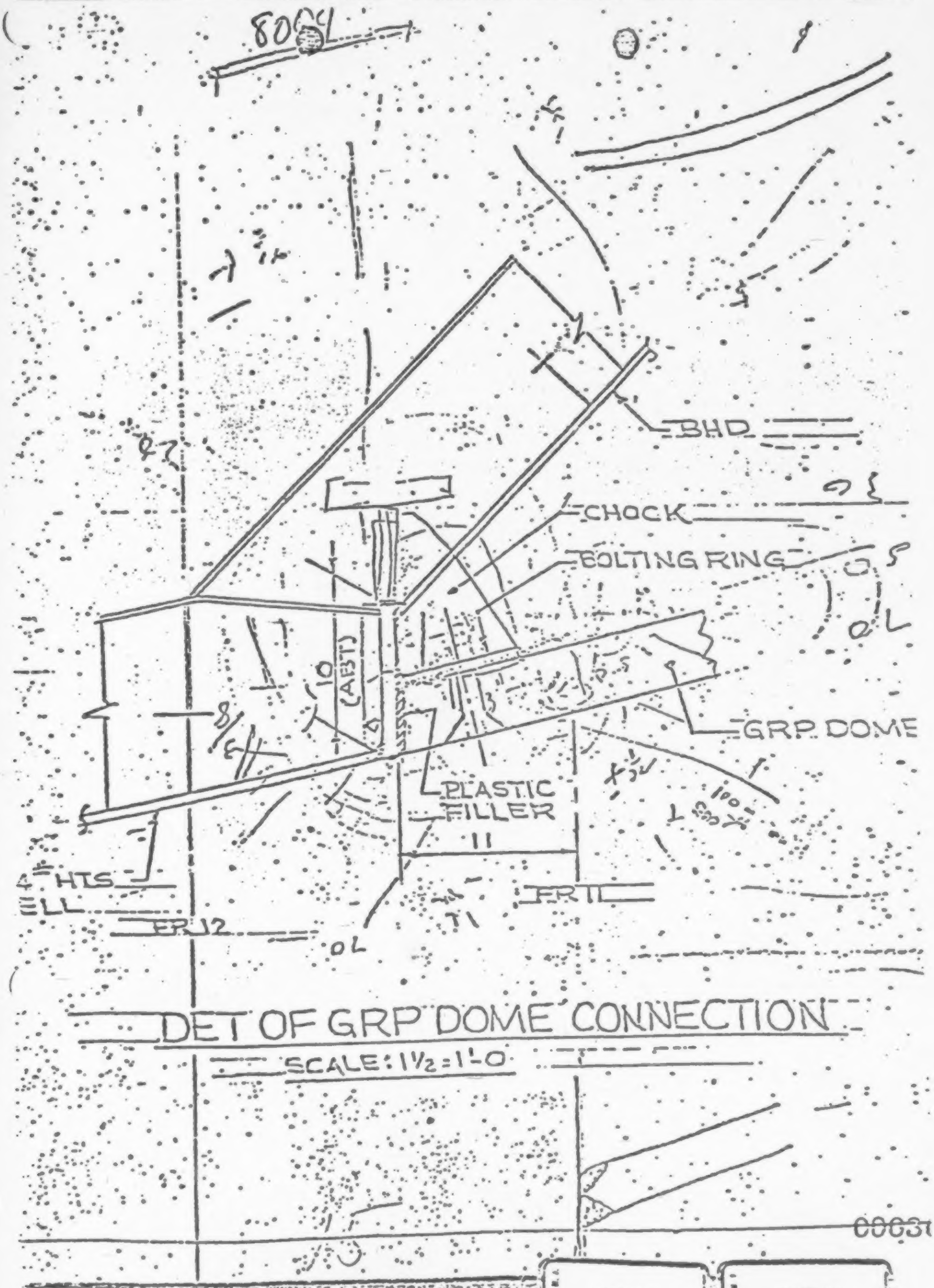
8. Enclosure (6) utilized enclosure (5) as the basis for the cost estimate for the installation of the glass reinforced bow dome. The estimator relied on the detail scope provided (enclosure (5)).

In conclusion, it appears that the "New Ship Estimator" relied on the bolted installation method suggested in enclosure (3) rather than on the welded installation method in enclosure (1) in estimating the cost of this work in the original proposal. The change estimator followed his instructions to price the entitlement provided in our request for equitable adjustment (enclosure (4)). Therefore, both estimates reflect the bolted structural angle ring dome attachm method. It may be debated that the Company priced the specifications and guida plans in the final contract price settlement without regard to our estimated submittal price for this work through reductions in submitted price or through end price settlement agreement. Surely, legal review and opinion exist on this subject and should be consulted.

W. T. Covington

W. T. Covington

/ 14


8064
BHD
CHOCK
BOLTING RING
GRP DOME
10 (ABT)
PLASTIC FILLER
11
4" HTS
ELL
FR 12
FR 11
0L

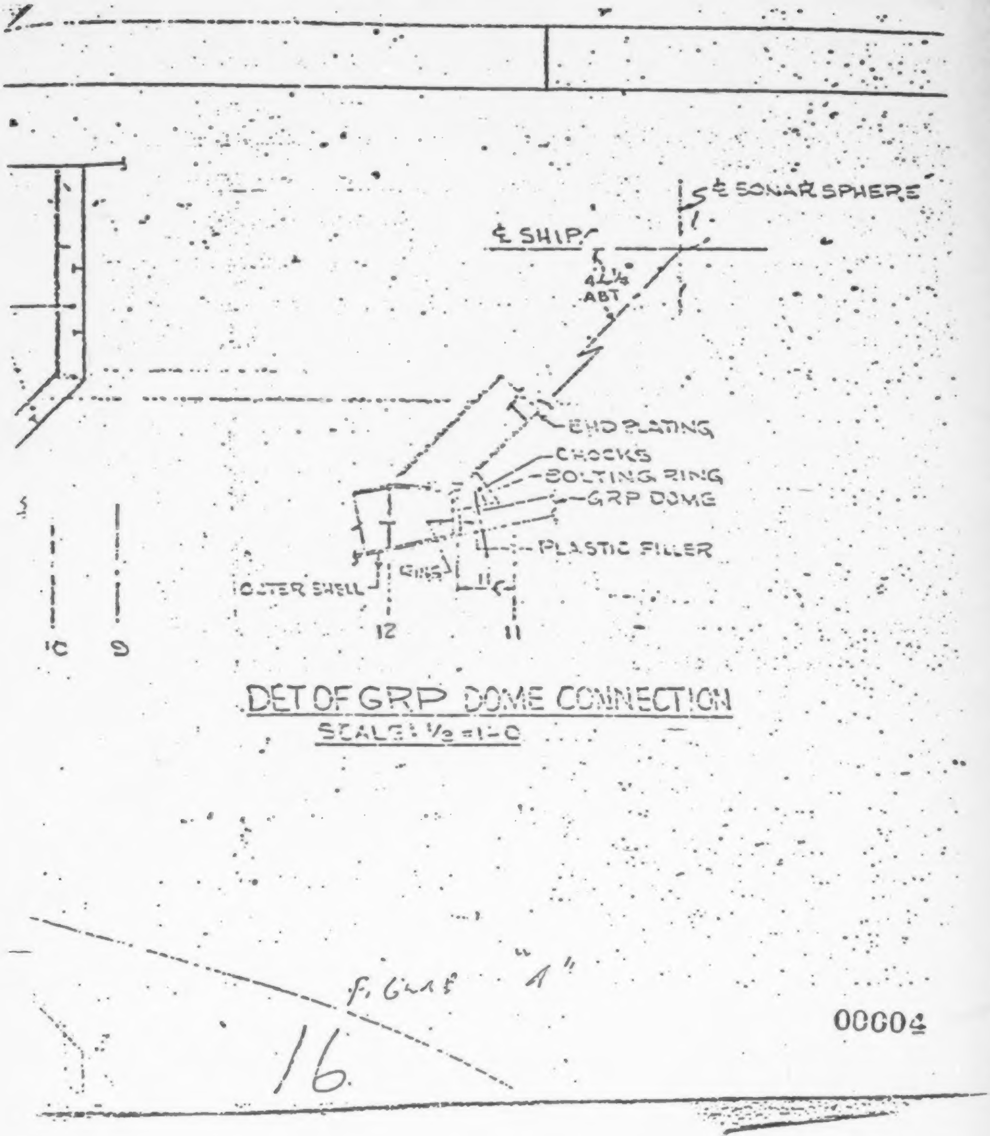
DET OF GRP DOME CONNECTION

SCALE: 1½=1'-0

EXHIBIT
WELDED
METHOD

EXHIBIT
Contract
Guidance Plan

EXHIBIT
NNS 341
P.O. 3034


℄ SONAR SPHERE
℄ SHIP
42½° ABT
END PLATING
CHOCKS
BOLTING RING
GRP DOME
PLASTIC FILLER
OUTER SHELL
12
11
10
9

DET OF GRP DOME CONNECTION
SCALE: ½ = 1'-0

Figure "A"

16.

EXHIBIT

J.E.T.
MAY 1 1970

NEWPORT NEWS, VIRGINIA

FILE NO. RECEIVED
APR 28 1970
DIVISION

April 27, 1970

MEMORANDUM For : File

SUBJECT : Trip Report of Mr. O. E. Davis, Foreman X11 Shipf Department to Mare Island Shipyard, Valeljo, California, Thursday 9 April Thru Tuesday 14 Apri

PURPOSE of TRIP : To Observe the Design, Fabrication and Installati Of Proposed New Type Sonar Dome Made of Fibergla Plastic for 688 Class Submarine Contracts.

PERSONNEL CONTACTED: Mr. D. O. Buer - Chief Designer of Mare Shipyar
Mr. P. Granum - Taylor Model Basin

REFERENCE : My Letter Dated December 22, 1969, on the Same Su

The purpose of this to Mare Island Shipyard was to observe and evaluate the final installation of the fiberglass plastic Sonar Dome.

Upon arrival at the Mare Island Shipyard, the Sonar Dome had been erected into approximate position and was in the process of being adjusted into final position. This adjustment was being done by doing some dressing and trimming at the lower outer shell which showed a jam fit, the top outer shell was open by 1 3/4". I was informed that the interference at bottom was Rubber Epoxy which was installed in error. During my observation of the mechanics of final installation it was noted that after final adjustment of the Sonar Dome, all holes in the structural steel bolting ring had to be reamed or elongated from 1/16" to 1/8" to permit installation of permanent bolting arrangement. I was also informed that all holes in the steel structural ring had been previously reamed .044".

I discussed the results of welding the structural steel bolting ring to the hull and was informed that the diameter of the ring increased from 1/16" to 1/8" oversize during the preheating and welding processes. I was informed also that the Sonar Dome had been trial fitted several times to the bolting ring, but this was questionable in my mind of their methods.

Excess material had been removed from the structural steel bolti ring leaving a minimum allowable thickness. With this condition existing the plastic Sonar Dome was still approximately 1/8" undersi the inside diameter. During my first visit in December the steel r was still attached to Plastic Dome with necessary bolts to position ring to ships structure and some weld attachments were being made bei removing for completion of welds. The David Taylor Model Basin Eng'r granted a request to remove the additional plastic fiberglass materi from the inside diameter of the Sonar Dome to facilitate mating to th structural steel bolting ring.

17. ENCLOSURE (3)

EXHIBIT
NNS 341
31-34

In conclusion, I feel that the "Fit-Up" will be acceptable although most of the holes will be oversize or elongated up to 1/8". In discussing future design changes with R. Fairfield, N.N. Hull Design and David Taylor Model Basin Engineer, Mr. P. Granum, the enclosed sketch was favorably accepted.

If this method of design for installation of the Sonar Dome is accepted, the following sequence of fabrication and events are suggested for Newport News use:

PROPOSED SEQUENCE

1. Navy assigned vendor to supply GRP Plastic Dome.

2. Newport News to fabricate and supply structural angle ring Item A of Enclosure (1) for attachment of Plastic Dome to ships structru to Navy assigned vendor for preliminary fit-up to dome by vendor.

   (a) Angle ring shape Item A to be 3/8" oversize in thickness.

   (b) Fabricate angle ring shape to + 3/8" Rad. oversize.

   (c) Machine face of angle flange for connection to ships structu maintain ± 1/8 plane.

   (d) Machine face of angle flange for connection to plastic dome to suit design dimensions.

   (e) Machine shop to record dimensions and ambient temperature simultaneously upon completion of machine work of angle rin

   (f) Ship angle ring to Navy assigned vendor.

3. Navy assigned vendor to install, drill, and bolt Newport News supplied angle ring to Plastic Dome as per design and maintainin angle flange face for connection to the ships structure to a plane of ± 1/8".

4. Newport News to design and fabricate ships structural items, enclosure (1) as follows:

   (a) Item F: Add 1" material at forward end and ½" material at outboard edge starting at fwd. end and tapering back approximately 36" to 0" material.

   (b) Item G: Add 1" material at forward end. Leave loose approximately a 36" band of ballast shell around circumfere ship until after Plastic Dome is fitted into position.

   (c) Item B: Add 1" material to outside diameter of plate connection ring.

   (d) Item C: Add ½" material to forward outboard edge starting outboard and tapering back approximately 36" to 0" material

   (e) Item D: Add ¾" material at outboard end.

18

5. Upon arrival of the Plastic Dome at Newport News, install Item B into position onto angle ring Item A attached to Plastic Dome, position Item B and drill holes 1/8" undersize and temporary bolt same. Move Plastic Dome with attached Items A and B into position for mating to ships structure, scribe into Items C, D, F, and burn off excessive material on same, make up and weld complet Remove excessive material on outboard edge of Item B and F, install Item G and weld completely remove temporary bolts, using an orderly sequence, ream holes to proper size and install permanent bolts.

O E Davis
O. E. DAVIS
Foreman
X11 Shipfitters Dept.

Copies:
1 - Mr. F. Zelle, Chief Hull Design
1 - Mr. R. Fairfield - Hull Design
1 - Mr. F. Kean - X10
1 - File
1 - Mr. J. E. Turner, Jr., Supt., X10 > NM

19

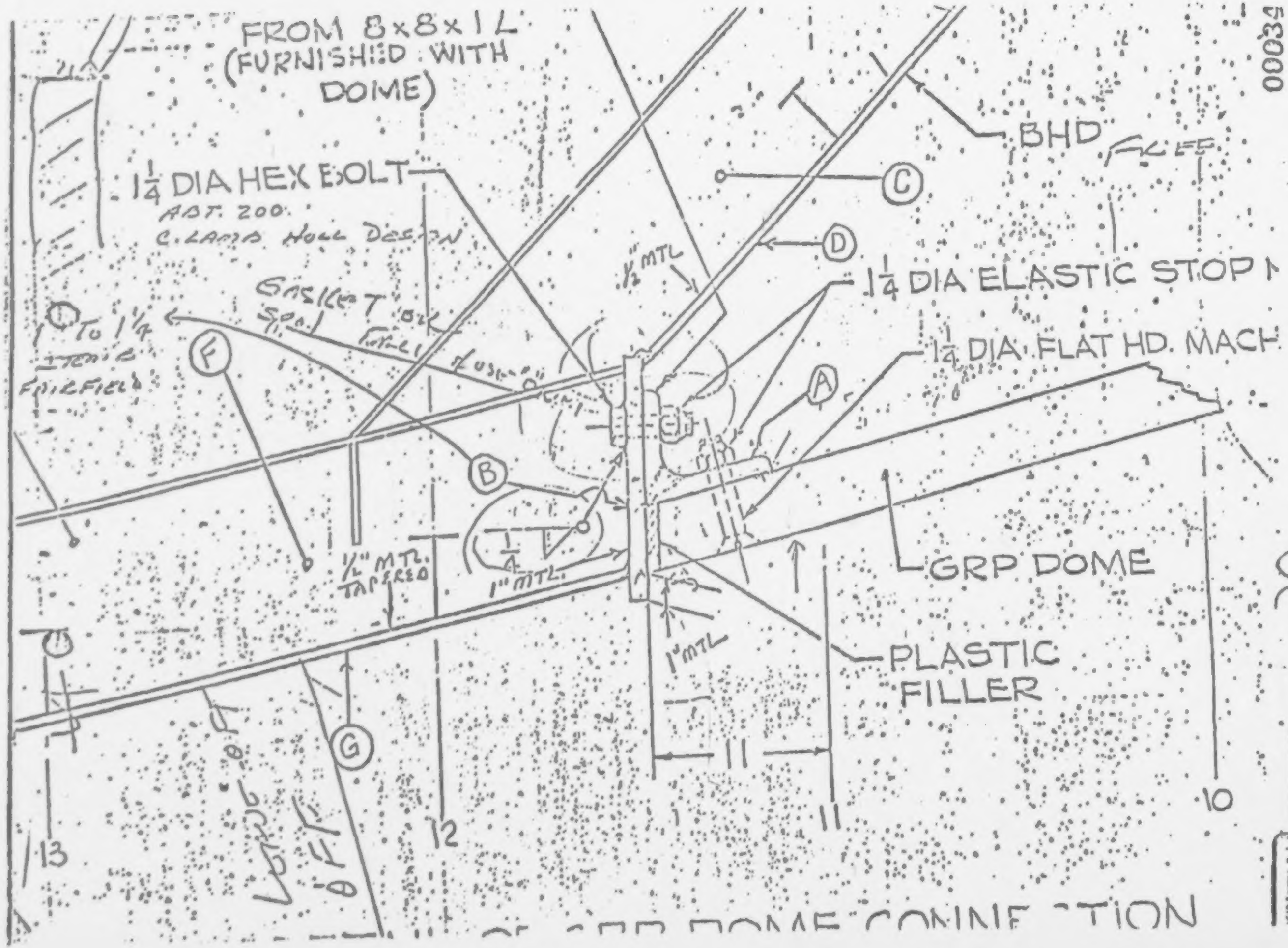

FROM 8×8×1 L
(FURNISHED WITH DOME)
BHD
$1\frac{1}{4}$ DIA HEX BOLT
ABT. 200
C. LAMB HOLL DESIGN
Gasket ok
Spal
$1\frac{1}{4}$ DIA ELASTIC STOP N
$1\frac{1}{4}$ DIA FLAT HD. MACH
$\frac{1}{2}$" MTL
1" MTL
1" MTL
$\frac{1}{4}$
$1\frac{1}{2}$" MTL. TAPERED
To $1\frac{1}{4}$
Fairfield
GRP DOME
PLASTIC FILLER
A
B
C
D
F
G
10
11
11
12
13
GRP DOME CONNE TION

EXHIBIT
NNS 311

EXHIBIT
NNS

VII.B.8. Glass Reinforced Plastic Bow Dome

The configuration and connection method for the glass-reinforced plastic bow dome, SSN688, was shown on Contract Guidance Drawing 800-4385833 furnished by the Government for bidding purposes. Such drawing showed the attachment for the glass-reinforced plastic bow dome connected to the hull by welding.

The Navy later discovered that the welded connection was impractical due to the weld distortion which occurred during installation by this method. The Government's Design Agent issued Drawing No. 1290-6, "Hull Attachment Ring, Glass Reinforced Plastic Bow Dome" which redesigned the bow dome connection to provide for a bolted connection. This redesign utilized 192-1-5/8 inch diameter K-Monel shoulder fasteners to attach the dome to the hull. The redesign necessitated the drilling of holes, reaming, and torqueing of the fasteners in accordance with the stringent specification requirements. The welding effort was not reduced by the change in the attachment method, since the attachment became a built-up angle that required welding in way of the flanges.

The design of the ring connection to the pressure hull as delineated on the working drawing developed by the Government's Design Agent was different from that originally anticipated and shown on the Contract Guidance Drawing. The original design required by the Contract Guidance Drawing is much simpler to execute and therefore less costly. The pricing details are included in Volume III.

21 ENCLOSURE (5)

EXHIBIT
NNS 341
P.36

INS 341

22

Beauregard Comments -10-
re: Bow Dome + Cathodic Protection!

④ BEAUREGARD COMME

Section VII.B.8
Glass Reinforced Plastic Bow Dome
Back-Up

The one Folder has prior drafts, and a Zelle (Hull Structural Design Department) memorandum (which is very good) of November 22, 1974. There is also a handwritten memorandum, written in Contract Controls, recording a decision to drop this Section, which was in the Mini, from the Maxi, a decision promptly reversed by Mr. Willis. The decision to drop this Section was based on the fact, discovered after the Mini was submitted, that the estimators were alerted that this change was coming and included the effect in their estimates. This fact is legally irrelevant and I concur with keeping this Section.

Comment

As long as the Contract Guidance Drawings and Design Agent's Working Drawing No. 1290-6 are available, I think that we are in good shape. Messrs. Ward and Bolt explained that the Data Bank has the Contract Guidance Drawing and Contract Controls has a copy of the Working Drawing.

Cost Estimates

The cost estimates are:

Hull:	SSN688	SSN689	SSN691	SSN693	SSN695
Mini:	$106,024	$110,794	$111,767	$117,580	$121,594
Maxi:	74,639	77,133	78,057	82,972	86,695

Again I suggest an explanatory analysis of the differences.

Section VII.B.9
Cathodic Protection
Back-Up

The one Folder contains the relevant NAVSEA Standard Drawing, the Working [illegible] There is also a handwritten

000

SSN 688 Proposal

III.B.8. Glass Reinforced Plastic Bow Dome

The configuration and connection method for the glass-reinforced plastic bow dome, SSN688, was shown on Contract Guidance Drawing 800-4385833 furnished by the Government for bidding purposes. ~~This Contract Guidance Drawing was used by the Contractor in the preparation of the estimate for~~ fitting and connecting the bow dome to the ship's hull. The Contractor had the right to assume that the information shown on this drawing was representative of the Government's requirements and provided reasonable guidance for the ~~preparation of a sound estimate.~~

no ¶ ~~The Contract Guidance~~ Drawing 800-4385833 Such drawing showed the attachment for the glass-reinforced plastic bow dome connected to the hull by welding. ¶ The Navy later discovered that the welded connection was impractical due to the weld distortion which occurred during installation by this method.

no ¶ The Government's Design Agent issued Drawing No. 1290-6, "Hull Attachment Ring, Glass Reinforced Plastic Bow Dome" which redesigned the bow dome connection to provide for a bolted connection. This redesign utilized 192 1-5/8 inch diameter K-Monel shoulder fasteners to attach the dome to the hull. ~~This radical departure from the Contract Guidance Drawing resulted in additional labor and material requirements for which the Contractor is entitled to reimbursement.~~ The redesign necessitated the drilling of holes, reaming, and torqueing of the fasteners in accordance with the stringent specification requirements. The welding effort was not reduced by the change in the attachment method, since the attachment became a built-up angle that required welding in way of the flanges.

NS 341

23

The ~~[illegible]~~ design
~~This~~ change in design/specifications was made ~~subsequent to Con-~~ after contract
award, and ~~the~~ design originally required by the
~~tractor preparation of his bid, and could not have been contemplated by the~~
Contract Guidance Drawing is much ~~less expensive~~
~~Contractor. This change has resulted in added costs to the Contractor, for~~
simpler to execute and therefore less costly.
~~which he is entitled to an equitable adjustment.~~ The pricing details are
Volume III.
included in ~~Section V.~~

III.B.9 Cathodic Protection

requirements of the specifications
working The original ~~estimate~~ for cathodic protection (hull zincs) for
were virtually identical to
SSN688 ~~was based on the~~ requirements of submarines previously built by the
after execution of both contracts
Contractor, ~~because the specifications were essentially unchanged.~~
drawings for as by the ~~Design~~ agent, ~~[illegible]~~
~~as the~~ ~~design of~~ the SSN688 developed the requirements for hull
es. ~~[illegible]~~ initial
zinc ~~increased significantly over the Contractor's interpretation.~~ The quantity
certain additionally, ~~the [illegible]~~
of zincs increased approximately 20 percent, ~~and~~ ~~installation~~ manhours ~~increased~~
for installing with [illegible] are
about 300 percent. ~~The marked increase in installation manhours resulted from~~
greater than welding.
~~the different methods of attachment of the zinc anodes to the hull.~~ In accor-
Government working of zincs
dance with the ~~applicable~~ drawings, installation on SSN688 required the installa-
tion of studs which had to be jig set, shot welded, cleaned, and painted before
the zincs could be installed on rubber grommets and bolted. ~~This multi-step~~
~~method increased manhour requirements approximately 300 percent~~ in comparison
The specifications invoked a NAVSHIPS Standard Drawing
~~to methods used previously.~~ which permitted the anode straps to
be welded to the structure.

welding on [illegible]

The Contractor is entitled to ~~reimbursement for the additional~~ an
equitable adjustment on account of ~~[illegible]~~ changes
~~costs resulting from the increased design requirements for~~ in [illegible] zinc anodes and the
Government's direction to use a more expensive
~~change in~~ installation methods. ~~This entitles the Contractor to reimburse-~~
~~ment for the added costs that were incurred in order to comply with the~~
~~ship drawings as finally developed by the Design Agent.~~ See ~~Section V~~ Volume III
for pricing details.

Doc. #371

RDV

N 26 (3321120)

INTER-OFFICE COMMUNICATION

NEWPORT NEWS SHIPBUILDING AND DRY DOCK COMPANY

A Tenneco Company

TO: Mr. J. H. Giedemann

FOR: Information

FROM: Hull Structural Design Department

SUBJECT: SSN688 Class Submarines, Our Hulls 600, 602 thru 605
Differences Between Contract Design Information and Working Drawings

JHG FILE NO. 600/9-1

DATE November 22, 1974

In response to your request to identify departures from contract guidance information and specifications for the subject vessels, per your memorandum, same subject, dated November 6, 1974, the following item is offered:

VIII.B.6. The Glass Reinforced Plastic (GRP) Bow Dome connection was redesigned from that shown in Panel 3-D of Contract Guidance Drawing 800-4385833. This connection, as shown, is welded to the hull, and after extensive investigation by Hull Structural Design and the Shipfitters Department, it was changed to a bolted connection. This bolted connection is detailed on NNS & DD Co. Drawing No. 1290-6.

The welded connection was installed on the SSN677 built at Mare Island Naval Shipyard and proved to be very impractical because of weld distortion during installation. This distortion caused the GRP Bow Dome to be refitted (enlarge the inside diameter) before reinstalling the Dome to the ring on the shipway.

The attachment used on the SSN688 Class, as depicted on NNS & DD Co. Drawing No. 1290-6, utilizes 192 - 1-5/8" diameter K-Monel shoulder fasteners to attach the Dome to the hull. This resulted in the additional work of drilling, reaming and torqueing with no reduction in welding since the attachment has become a built-up angle that required welding in way of the flanges.

F. Zelle
F. Zelle
Design Manager

RHF/FZ:rem-4
One carbon duplicate herewith

1 - Mr. R. H. Fairfield
1 - Mr. F. Zelle

Good - use as is, cost Engineer's should be able to give diff. in type of connection (from weld to bo

RW 12/2/74

0008

NNS 341

25

7/22/75

G.CP Dome

Canceled as of 7/21/75

Doug Bult in discussing w/ Bob Fairfield who by the way originally identified the problem as a discrepancy in contract reqmts as denoted on CSD, found that the resolution for method of attachment was made in May 71 & included in bid estimate.

We evaluated bid (discussed w/ Curt Mischke) and the bolted attachment was included in bid. 4200 man-hours were estimated. The returns in July 75 were 3200 manhours on H200 (only)

BFB - agreed to drop.

7/21/75

Newport News Shipbuilding
Tenneco Company

4101 Washington Avenue
Newport News, Virginia 23607
(804) 380-2000

600/C1-1-1
600/1-4-979.01
October 4, 1978

Supervisor of Shipbuilding
Conversion and Repair, U. S. Navy
Newport News Shipbuilding and Dry Dock Company
Newport News, Virginia 23607

Attention: Contracting Officer

Subject: Proposal for Equitable Adjustment of Contracts N00024-70-C-0269 and N00024-71-C-0270, SSN688 Class Submarines

Reference:
(a) Newport News Shipbuilding Letter CONTRACTS/GEN, 800/C1-1-1 dated March 8, 1976

Dear Sir:

Reference (a) forwarded our Request for Equitable Adjustment (REA) of the subject contracts. Continuing review has revealed several areas in which corrections or clarifications are in order. Therefore, to comply with the requirements of Public Law 87-653 as they relate to the submission of data either actually or by specific identification in writing, the following information is hereby submitted:

1. Volume II, Book 1 of 5, Section VII.8.8, Glass Reinforced Plastic Bow Dome - Our review of this section indicates that a design similar to the one shown on Drawing 1290-6 was included in the bid proposal. Currently, the Company is conducting a review in order to determine whether the design concept utilized in the bid was the same as set forth in Drawing 1290-6.

2. Volume II, Book 1 of 5, Section VII.8.9, Cathodic Protection - A review of this section indicates that the method used for installing zincs on SSN688 was also used on previous submarines, including the one used as a basis for the SSN688 bid proposal. Also, the number of zincs may be greater than that reported in the REA.

As you are also aware, during contract negotiations the parties agreed to a significant lump sum reduction in the Company's initial proposal. We cannot advise at this time whether any change is necessary to the REA. Upon the completion of our review, we will advise the Government of any changes.

As additional corrections or clarifications become known, we will submit them for your consideration.

Yours very truly,

B F Bridges

B.F. Bridges
Senior Contract Manager

One duplicate herewith

Copies:
Mr. C. E. Dart
Mr. E. B. Adams, Jr.
Mr. V. F. Ewell, Jr.
Mr. C. L. Willis
Mr. J. A. Konouck
Mr. R. M. Hall, Jr.
CO Vault

03004

28

ATE OF HULL DETAILS
ENGINEERING DEPT.

2075	HULL NO.	CHARGE NO. 10270	DATE 5-16-70

ITEM	QUANTITY	FINISHED WEIGHT		MAT	MATERIAL		LABOR		MH
		UNIT	TOTAL	W.R.	UNIT	TOTAL	UNIT	TOTAL	
STALLATION OF					N.V.P.				
GOV'T FURNISH SONAR DOME									416
SAY					JAN 14 1972				420
ATERIAL						13723			
SAY			30.000			13700			
EIGHT TO HANG DOME FOR						5800			
J. MADE RING									
						19,500			420

EXHIBIT
SCAT #1
4 PR

[illegible] 137

[illegible] TO THE [illegible]
THE TITLE PAGE OF THIS [illegible]

ENCLOSURE (1)

24
21

ATED BY C. [illegible] 5-10-70	CHECKED BY 10270-1	CHARGE NO. 10270

EXHIBIT
NNS 960
pp. 5-8

FORM 65-1 (3321463)

Sonar Dome

Estimated break down cost in man hours of sonar dome, according to memorandum, sketch and meeting with Mr. O.E. Davis Foreman X-11 Fitters on May 13, 1970

Fabricate Angle Ring Item A	400
Machine " " " "	40
Erect and set Item B	64
Drill Item B Template from	300
Item A 1/8" small	—
Bolt Item A to Item B	128
Erect, set & scribe Item A + B with	192
sonar dome to ship structure	
Burn, chip & clean ship structure	224
Reset Item A & B with Dome & adjust	64
Make up all structure at	400
connecting points to Items C, D, F & G	
Weld structure complete & M.T.	800
Dress & fair ship structure	160
to suit sonar dome	
Ream holes to correct diameter	120
Spot face or install gasket	120
Bolt up Item A & B complete	200
Fill with plastic between both	200
Dome & ship structure	—
Handling after arriving at yard	250
Fabricate lifting & handling fixt	200
Preparing Angle Ring Item A for	300
shipping	
TOTAL	4162
SAY	4,200

USE OR DISCLOSURE OF PROPOSAL DATA
IS SUBJECT TO THE RESTRICTIONS ON
THE TITLE PAGE OF THIS PROPOSAL

CJM 10270-2

20

RM 63-1 (3321463)

SONAR DOME

MATERIAL

1 pc. 56.1# PLT. 120" LONG x 68" WIDE TO FABRICATE ITEM A
3192# AT 29.99 # = $957

2 pcs. 51.0# PLT. 300" LONG x 150" WIDE TO FABRICATE ITEM B
31,876# AT 29.99 = $9560

200 - 1¼" x 4" MONEL H.H. BOLTS 5.461 Pc. = $1092 (97-60-45

200 - 1¼" DIA. ELASTIC STOP NUTS MONEL 5.263 Pc. = $1053 (97-60-80

Plastic Filler - Estimated Cost = $150

6000# STEEL FOR FND & HANDLING AT 15.18 = $911

ITEM 1 - 957 ✓
2 - 9560 ✓
3 - 1092
4 - 1053
5 - 150
6 - 911 ✓

TOT: 13,723

USE OR DISCLOSURE OF PROPOSAL DATA
IS SUBJECT TO THE RESTRICTIONS ON
THE TITLE PAGE OF THIS PROPOSAL

7

RGM 10270 - 3

31

600H - SONAR DOME RING

STEEL RING - ABOUT 25' DIA. & 8"

TO LOS ANGLES, CALIF. - 3500# W/CRATE

BARGE — $175,000.00 NO

5/18/70

BARGE - BALT QUOTE — $3300.00 ALONGSIDE

FOB DOCK @ LONG BEACH - CALMAR LINES = $2400.00

ADD 75¢/CWT FOR INSURANCE

BARGE -	3300
SHIP	2400
INS.	100
	$5800

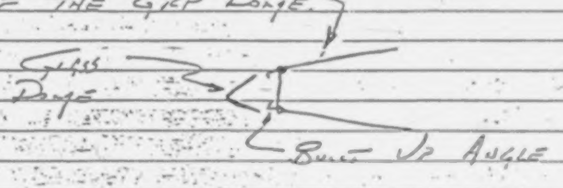
USE OR DISCLOSURE OF PROPOSAL DATA
IS SUBJECT TO THE RESTRICTIONS ON
THE TITLE PAGE OF THIS PROPOSAL

LEMAY - 2830

10270-4

ASSUMPTION

No Credit For Welding Of Attachment Ring To Hull (Old Method) Due To Modifications To Flanges (Built Up Angle) To Allow For Bolting Of The GRP Dome.



Mat'l For Bolt As Follows

192 / $1\frac{5}{8}$" Dia K Monel Shoulder Bolts (As Per W

$1\frac{5}{8}$" Dia Bar (K-Monel) = 2^{00}/# Est {Based on P.O. [illegible] DTD 11/91 = 2^{4}#/1.29 [illegible]

∴ 7.78#/FT

192 Bolts @ 7" = 112' + 20% Waste = 134'

134' × 7.78#/FT = 1043# × 2^{00}/# = 2086^{00} ÷ 192 = 11

Washers, Nuts, Etc = Say 9^{00} Bolt

Bolt = 11^{00}

Washers } 9^{00}
Nuts }

20^{00}

Fabrication Of Bolts (Est) Say 12 M/H Bolt

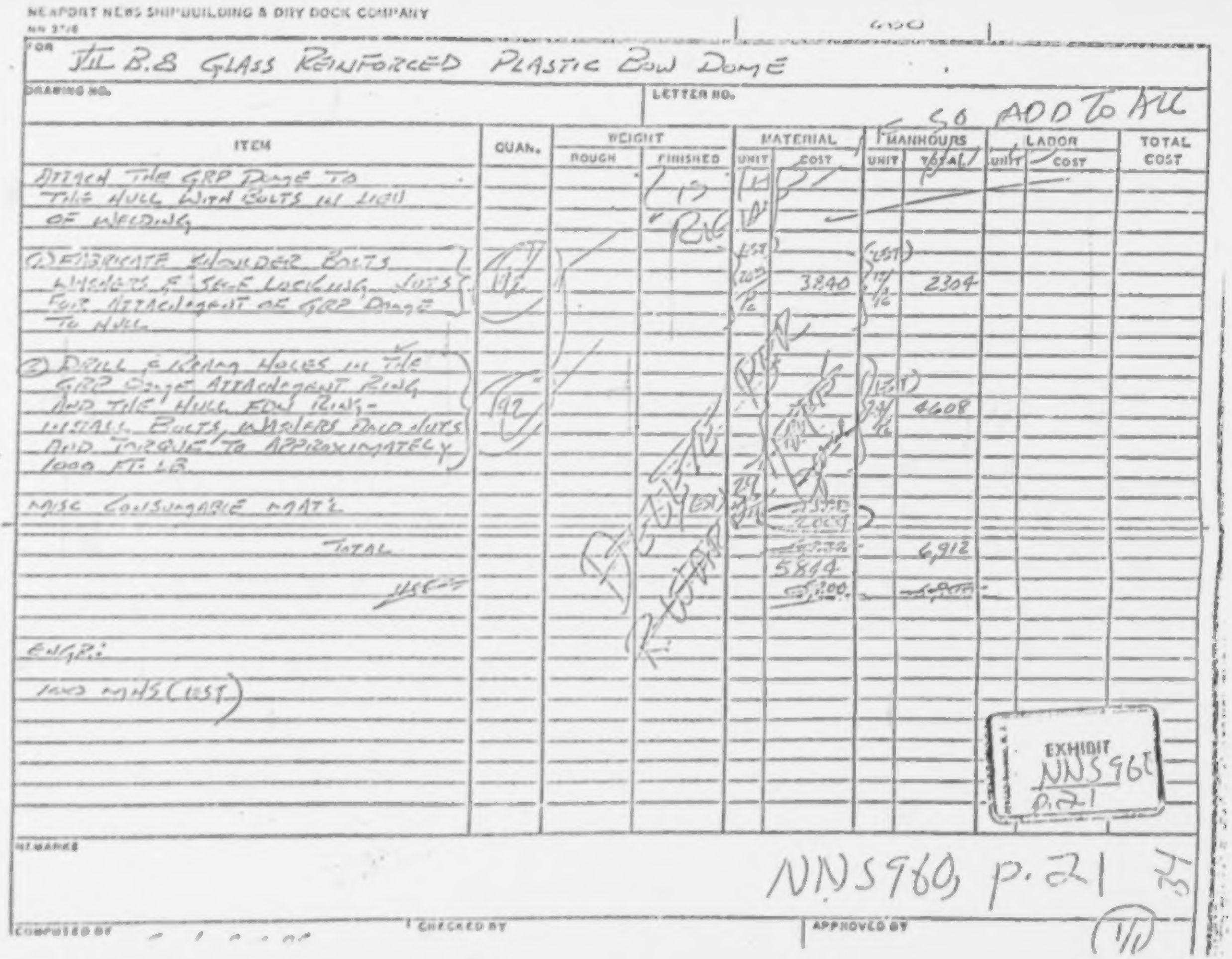
GWH
8-8-95

33

NNS

EXHIBIT
NNS460
p.13

13



NEWPORT NEWS SHIPBUILDING & DRY DOCK COMPANY
NN 3718

600

FOR VII B.8 GLASS REINFORCED PLASTIC BOW DOME

DRAWING NO.

LETTER NO. 50 ADD TO ALL

ITEM	QUAN.	WEIGHT		MATERIAL		MANHOURS		LABOR		TOTAL COST
		ROUGH	FINISHED	UNIT	COST	UNIT	TOTAL	UNIT	COST	
ATTACH THE GRP DOME TO THE HULL WITH BOLTS IN LIEU OF WELDING										
(1) FABRICATE SHOULDER BOLTS WASHERS & SELF LOCKING NUTS FOR ATTACHMENT OF GRP DOME TO HULL	192			(EST) 20	3840	(EST) 12	2304			
(2) DRILL & REAM HOLES IN THE GRP DOME ATTACHMENT RING AND THE HULL BOW RING - INSTALL BOLTS, WASHERS AND NUTS AND TORQUE TO APPROXIMATELY 1000 FT-LB	192					(EST) 24	4608			
MISC CONSUMABLE MAT'L				(EST)	~~[illegible]~~ 2004					
TOTAL					~~[illegible]~~ 5844		6,912			
USE					~~5,200.~~		~~[illegible]~~			
ENGR:										
1000 MHS (EST)										

EXHIBIT
NNS960
p.21

REMARKS
NNS960, p.21

COMPUTED BY
CHECKED BY
APPROVED BY

(1/1)

EXHIBIT R

OCTOBER 1980 -- NORMAN SUPPLEMENTAL PROSECUTION MEMO

SUPPLEMENTAL PROSECUTIVE REPORT--NEWPORT NEWS SHIPBUILDING (NNS) PROCUREMENT FRAUD INVESTIGATION

TABLE OF CONTENTS

PAGE

SUMMARY OF RESULTS OF INVESTIGATION 1

1. Ventilation Control Air System (VCAS) 2

2. Cathodic Protection and Bow Dome 11

3. Cu-Ni Tubing 11

4. Intermediate Gage Cutout Valve 14

5. CVN 68 Delay 18

6. CVN 69 Delay: Shipway Utilization 27

7. CVN 69 Delay: Innerbottom Shielding 33

8. Fictitious Manhours 45

9. Prearranged Target Values 51

10. Other Items 58

11. Proof of Intent 59

Eliot Norman
Assistant United States Attorney

GRAND JURY MATERIAL
DO NOT DISCLOSE

EXHIBIT
5

NNS-48

SUPPLEMENTAL PROSECUTIVE REPORT--NEWPORT NEWS SHIPBUILDING (NNS) PROCUREMENT FRAUD INVESTIGATION

After the last major grand jury session in November, 1979 the staff prepared a number of prosecutive reports for review by the United States Attorney. The reports focused upon three individual claim items,* although the report on the Bow Dome also discussed a number of larger issues in the case. The staff then met with the United States Attorney in the Spring of 1980 to discuss what further action, if any, should be taken. It was decided to conduct a limited inquiry, focusing upon those items that offered at least some potential for prosecution under 18 U.S.C. §287. To that end, the Assistant Attorney General authorized the first grants of immunity in the case. A limited number of witnesses were summoned before the grand jury in the spring of 1980 and that phase of the investigation was completed in June.

The purpose of this Supplemental Report is to summarize the results of the investigation conducted in the spring of 1980. The Report will also discuss a number of issues and items that have been under investigation since the grand jury was empanelled in October of 1979. This Report should be read together with the prior Report of the undersigned Assistant United States Attorney on the Bow Dome and other issues in the investigation. Although this Report will not be as detailed as prior submissions, it should offer a firm basis for a prosecutive decision in this matter. In that regard, the unanimous recommendation of the staff is to close the investigation without further inquiry. There is insufficient evidence to believe that Newport News Shipbuilding (NNS) violated 18 U.S.C. §287 when it filed claims for cost overruns in the construction of nuclear submarines, carriers and cruisers for the United States Navy.

---

*Bow Dome; Cathodic Protection; and Reactor Ventilation Control Air System (VCAS).

1. Ventilation Control Air System (VCAS). Extensive analysis of this item can be found in Saundra Adkins' Prosecution Report dated 5 March 1980. [redacted] The VCAS claim is based upon the premise that the Navy supplied Newport News Shipbuilding (NNS) with a vague and misleading Contract Guidance Plan. NNS alleges that it could not tell from the Navy's Plan that the ventilation system in the reactor plant of the CGN 38 (a nuclear-powered cruiser) was supposed to be a larger and more complex system than its predecessor on an earlier ship, the CGN 36. Specifically, NNS states that the Plan for the Ventilation Control Air System (VCAS) was inadequate with respect to piping and did not provide sufficient notice that the system to be installed was to be a nuclear as opposed to a non-nuclear system like the one used on the CGN 36. As a result, when NNS relied upon the Guidance Plan in preparing its contract proposal for the CGN 38, it underbid the VCAS by about $1 million. In its claim, NNS requested reimbursement for the added work, delay, disruption and related costs caused by the necessity of changing the design of the VCAS after ship construction commenced.

[redacted]

[redacted]

The government's prosecution theory had two prongs. [redacted]

[redacted]

[redacted]

The staff feels that this type of defense would not get very far in either a criminal trial or a civil or administrative ASBCA hearing. [redacted]

In this area of technical judgments, it is apparent that the claim was "blown" somewhere between the Atomic Power Division, Cost Engineering, and the Contract Controls Department. Three years later, when the parties found out that the engineers' criticisms were correct, the language regarding a "vague and misleading" Guidance Plan was withdrawn. The staff is confident that it could win this claim if it had been presented before the ASBCA. It is wrong and by 1978 everybody knew it. The staff also believes, however, that there was no deliberate effort to [redacted] at the time the claim was submitted.

Concerning the second prong of the prosecution theory, [redacted].

[redacted]

[redacted] For these reasons the staff unanimously recommends that prosecution be declined on the CGN 38 VCAS item.

2. Cathodic Protection and Bow Dome. No information was obtained since March of 1980 which would change the staff's recommendations regarding these items. The sequence of events surrounding these claims can be described as follows. [redacted] What cannot be shown, however, is any intent by Willis to do something which the criminal law forbids.

Grd-Jury

3. Cu-Ni Tubing. It was alleged that NNS, at Willis' direction, withheld current pricing data regarding Cu-Ni Tubing

and other items in the 688 "Mini" claim. Investigation revealed that the Defense Contract Audit Agency (DCAA) auditors were unaware in October of 1975 that each of the items in the "Mini" claim which they had been reviewing had been re-priced. For example, when one DCAA auditor asked about the accuracy of the Cu-Ni Tubing figures, the cost engineers withheld the information that the item had been overpriced in the "Mini" by about $600,000.00. That information was not provided until March of 1976 when the final version of the claim was submitted to the Navy, a delay of some five months.

The problem with proceeding criminally is lack of proof of criminal intent. All parties concerned knew that prior to any settlement of the 688 "Mini" claim, the pricing of each item would be revised to reflect the most current data. This would be done to protect the shipyard against any defective pricing claims under the Truth in Negotiations Act, 10 U.S.C. §2306 et. seq. The parties also knew that the 688 "Mini" claim, which was the subject of the DCAA audit in the fall of 1975, was a first or rough draft and subject to revision if it could not be settled. Several items in the "mini" claim had been deleted at the request of negotiating Navy officials. Others had been slashed by more than 50 percent in price in an effort to reach a settlement.

[redacted]

[illegible] the [illegible] the [illegible]

[redacted]

Although the variation in the Cu-Ni Tubing price was large and in the government's favor by nearly $600,000.00, there were an equal or greater number of items which were underpriced by the shipyard in its "Mini" claim. The overall result was that the withholding of current price data for five months meant that the shipyard was willing to settle a claim which in its entirety was underpriced by about $2-$3 million. This "underpricing" aspect tends to negate any intent to obtain additional monies which NNS knew it was not entitled to. As previously stated, NNS had already slashed some items from 20 percent to 50 percent of face value in order to work out a compromise.

Another key factor in assessing the allegations regarding the withholding of current price data is the state of knowledge of Navy negotiators in 1975. The responsible Navy officials knew that the "Mini" claim was submitted to obtain a quick settlement for about $50 million. They also knew that it was a draft version of a larger more complete claim that would come in for $50-$100 million more in target cost value. Finally, the Navy officials knew that any delays in the DCAA audit would kill the chances of a quick settlement. For this reason, the Navy officials were not too concerned about any discrepancies in individual items so long as the total package in their hands was not out of line, generally speaking, with the total package they knew the shipyard was working on. Had the efforts to settle been successful, the Navy were well aware that they would have received in December, 1975 final pricing figures to replace those in a draft version. When the deal fell through, NNS submitted its final version of

? What Official

the claim for twice the amount of the "Mini" ($200 million vs. $100 million in face value) and included with it the revised pricing figures. The delay in submitting the final claim accounted for the five-month delay in submitting revised pricing figures.

[redacted] The key Navy negotiators knew this and tacitly approved Willis' decision to withhold the data from DCAA. Under these circumstances, criminal intent cannot be proved.

4. Intermediate Gage Cutout Valve. The claim states that in 1973 the Navy's design agent, RPPY, required the addition of 124 Intermediate Gage Cutout Valves (IGCVs) which were not called for in the ship specifications. NNS asked to be reimbursed for the added work.

The investigation revealed that the valves were not added in 1973 by RPPY but were added in 1968 or 1969 by the shipyard prior to contract definitization. In short, it could be argued that NNS was asking to be paid for work which was already covered or should have been covered by the original contract specifications.

[redacted]

[redacted]

A concerted effort was made to find out if there was a deliberate effort to suppress information of inaccuracies in the claim during the September, 1977-February, 1978 period. The five-month delay can basically be explained by the time required to compile new drafts of the claim and submit them to Contract Controls and the Legal Department for review. It is also relevant to consider the fact that the Navy had publicly identified deficiencies in the claim item in December, 1977. In other words, NNS personnel knew that the Navy knew there was something wrong with the item and NNS was not going to submit a revised version of the claim until it could be perfected. A combination of political pressure from the Navy and the inability by the claims writers to satisfy both factions of engineers led to the decision in February of 1978 by legal counsel to withdraw the item. The IGCVs accounted for a very small monetary part of a $200 million claim and the general attitude by the claims people was that it just wasn't worth the trouble.

As with Cathodic Protection, the validity of the IGCV item turns basically on an issue of contract specifications, about which there is room for at least two interpretations. The Navy insists that the specifications require addition of the valves since they provide for IGCVs as an alternative means of designing the system in question. [redacted]

The bottom line is that the government can probably prove that there is no contractual entitlement for this item. But the government cannot prove that the claims writer willfully mis-stated the facts prior to submission of the claim. [redacted] Aside from the date the claim says the valves were added, the government cannot prove beyond a reasonable doubt that the claim is false. Finally, there is no proof of suppression of evidence of the claim deficiencies [redacted]

5. CVN 68 Delay. The Nimitz, CVN 68, was a new design aircraft carrier in that it was powered by only two instead of four nuclear reactors. Each reactor aboard ship is capable of delivering more power than the reactor which malfunctioned at Three Mile Island. Together, the two nuclear power plants can drive the CVN 68 at speeds of close to 40 knots.

The CVN 68 took from 1967 to 1975 to build. A factor controlling delay in the delivery of the Nimitz to the Navy was the Reactor Plant Acceptance Test Program. The test program was jointly administered by the Navy and by NNS. It took close to 510 days or 15 months to complete. Each step in the program--from the initial fill of the primary system under cold operations to hot operations to full power range testing under critical conditions--was meticulously controlled according to government furnished operations manuals. No steps could be short circuited. There are no safe shortcuts in the process of bringing a nuclear reactor on-line.

Snafus in the test program could and did occur in a number of areas. In general, the government was responsible for furnishing information and materials; and the contractor was responsible for providing the manpower and for carrying out the tests. If government-furnished information (GFI) was deficient or if government-furnished materials (GSM) were inadequate, any resulting delays were the fault of the Navy. On the other hand, if shore-based steam necessary to conduct a particular test was unavailable or if a workman dropped a wrench and damaged a valve, the resulting delay was the responsibility of the contractor.

On occasions concurrent delay occurred, for which both the Navy and NNS were responsible. For instance, suppose the Navy supplied the wrong sized valve and it took 24 hours to replace it. Suppose also that the shipyard's generators broke down during the same 24-hour period so that no tests could have been run due to lack of power. In such a case, the end result would be that delay would be the fault of both parties and could be blamed on neither.

The "Bible" of the test program is the Shift Test Log, completed and signed by the Navy and the NNS Shift Test Engineer. These logs, numbering thousands of pages, show each event which occurred on a minute-by-minute basis over the course of the 510-day test acceptance program cycle. Like hospital records, they show every vital sign. The only difference is that the patient is a nuclear reactor.

The Shift Test Log, like the daily hospital record or nurses' notes, is just the first step in analyzing the problem. [redacted]

It is precisely in the "why" area as opposed to the "what happened" area that three groups of experts offer three different opinions. They are: the Navy Code 08 nuclear engineers from Admiral Rickover' department; the Navy nuclear engineers from the Navy Claims Settlement Board Team and from the Navy's Carrier Project Office who spent nearly one year analyzing the CVN 68 Delay claim; and the NNS nuclear engineers.

[redacted]

NNS did not claim, however, 160 days of delay in its Proposal for Equitable Adjustment. [redacted] Accordingly, the contractor requested compensation for only 123 days delay at a cost of $125,000.00 per day or approximately $15.6 million.

The analysis done by the shift test engineers from Navy Code 08 was conducted in a similar fashion. They relied almost exclusively on the shift test logs. They found that 17 percent of the delaying events attributed to the Navy by NNS in its claim were clearly wrong. The engineer found that at least 37 days out of the 160 days of delay identified by the shipyard were caused by events falling within the contractor's area of responsibility. Yet another analysis was conducted for nearly one year by the Navy engineers assigned to review the CVN 68 Delay claim. These engineers found that about five percent of the delaying events attributed to the Navy were the shipyard's fault on factual grounds.*

[redacted]

[redacted]

---

*At this juncture it may be appropriate to point out that neither Navy analysis would have changed the final result. Since the shipyard claimed that the Navy was responsible for only 123 of the 160 days of Navy-caused delay that it identified, a reduction of the 160-day figure by 37 days or 17 percent or 5 percent would have resulted in no net change in the total amount of the delay claim. It should also be kept in mind that the figure disputed by the Navy was much higher than 17 percent. The Navy disagreed with much of the delay claim on legal and contractual grounds and was willing to pay NNS less than $.25 on the dollar. Such legal grounds are not relevant, however, to a criminal fraud case.

[redacted]

[redacted]

These investigative results led to a re-evaluation by the staff of its initial conclusions. It was hard to imagine deliberate misstatements in only two of 100 delaying events. To put it another way, if the shipyard was going to defraud the Navy in this area, the claim should be full of false interpretations of the nuclear engineering logs. If only two percent of the entries are false, one begins to talk in terms of negligence rather than deliberate fabrication of evidence.

After consultation with the Navy engineers and review by them of the grand jury transcripts, it was decided that they would conduct further research into the two suspect items. In the interim the staff would begin to [redacted]

[redacted]

[redacted] They found documented proof of a dust problem with the valves due to extended storage time. The government could argue in a civil forum that proper storage was the contractor's responsibility. However, the flip-side of the argument would be that the government acknowledged responsibility for delay in the CVN 68 in an earlier contract modification (HMR 81). And, because the delay caused unforseen storage problems not covered by the contract, dirt accumulation which caused the valves to fail and the test program to be delayed could be blamed on the Navy. These types of arguments could only be resolved by a legal interpretation of the prior modification, HMR 81. Had the matter proceeded to a hearing before the ASBCA, the issue would not have been factual but whether storage and the logical result of storage, i.e. dust, was a time-related cost not compensated by HMR 81.

Such legal arguments are interesting but not relevant to a criminal prosecution. At issue is the question of fabrication of the facts. [redacted]

[redacted] The staff found at least some proof of dust storage problems and documentary evidence thereof.

When one steps back and looks at the CVN 68 Delay claim as a whole, one realizes that resolution of the causes of delay will turn on the judgment of nuclear engineers. Like a medical malpractice trial at which physicians, after reading the operating notes, can reasonably disagree regarding the course of practice that the surgeon should have followed; the nuclear engineers, after reading the Shift Test Logs, can reasonably disagree regarding the causes of delay.

Finally, the staff did not stop in its research where there was an issue of engineering judgment. Each and every allegation of false statements by Rickover's staff was checked against the original logs and other source materials. Where those logs did not provide satisfactory answers, independent research was done by the staff engineers or witnesses were questioned before the grand jury. The bottom line is that the staff was unable to prove by at least clear and convincing evidence that the allegations were factually false.*

6. CVN 69 Delay: Shipway Utilization. Delivery of the nuclear-powered aircraft carrier, USS Eisenhower, CVN 69, was delayed by about 731 days. NNS essentially attributes all of this delay to the government because of government-caused delays to the USS Nimitz, CVN 68. For example, NNS states in its claim that it was unable to maintain sufficient manning levels on the

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*In the end, the Navy engineers advising the staff were forced to admit that the NNS engineers had done a credible job in researching the CVN 68 Delay claim.

. The attached page from the claim, with its cross references to contemporaneous engineering logs, demonstrates the extent of the research effort, the conclusions of which could not be positively refuted. (See the Sample Claim Pages Attached.)

CVN 69 because it had to keep skilled craftsmen, particularly nuclear welders and other workers on the Nimitz for extended periods of time. Consequently, the expected rollover in trades could not occur as planned. The Navy acknowledged and admitted that it was responsible for much of the delay to the CVN 68 because of late delivery of key nuclear components and other causes in a contract modification, HMR 81. The Navy denied that its admission in HMR 81 covered any delays to the CVN 69.

The debate over the extent to which delay to CVN 68 caused delay to CVN 69 and the extent to which the Navy committed itself to pay for delay to either ship under HMR 81 cannot be easily resolved. There are colorable legal and contractual arguments for both sides. Regarding the extent of delay, both sides compiled computer models and theories of delay which were not easily susceptible to the type of analysis required for a criminal fraud case. However, because the quantum of damages claimed for CVN 69 Delay was so large, the staff did not want to leave this area out of the scope of its investigation without attempting to determine if fraud had occurred in one or more of the areas where the facts were fairly straightforward. Thus, it was decided to take a close look at representations by NNS in this area regarding use of Shipways 9 and 11 to construct the CVN 69.

By way of background information to its claim for delay on the CVN 69, NNS stated that:

> As originally planned, when CVN 68 was launched, CVN 69 was planned to replace it in Shipway 11. However, due to the problems encountered in CVN 68 construction, CVN 69 could not replace it in Shipway 11. To mitigate the effects, the contractor revised his planning and began construction of CVN 69 in Shipway 9...The limitations on the construction effort imposed by the necessity to begin construction in Shipway 9 instead of Shipway 11 are obvious...

The statements in the claim regarding Shipway 9 are factually correct. Shipway 11 is the only drydock in the free world which is large enough to build a nuclear-powered aircraft carrier. Because of the size of Shipway 9, it was necessary for NNS to float the CVN 69 out of Shipway 9 when it was only partially complete and finish the job in Shipway 11. The CVN 69 is over 1000 ft. long and Shipway 9 could accommodate only 600 ft. of the aircraft carrier.

The placement of the cranes in Shipway 9 also restricts the height of any aircraft carrier constructed in that Shipway. Generally speaking, a carrier cannot be constructed any higher than its fourth deck. When completed in Shipway 11, an aircraft carrier is taller than a 20-story building from keel to the top of the control tower.

The key issue raised by the claim language is not its description of Shipway 9 but its references to revisions in planning. When the Navy received the claim in 1976 it immediately seized upon such language as a prime example of blatantly false representations. Both sides during the construction process (which began in 1967 and continued until 1977) had copies of all the NNS construction schedules for the CVN 68 and CVN 69. No schedule, even going back to 1968, showed launch of the CVN 68 from Shipway 11 and the laying of the keel of CVN 69 immediately thereafter in the same shipway. Everyone in the Navy familiar with the CVN 68 and CVN 69 remembered NNS representatives explaining to the Navy in 1969 that the yard was capable of exercising an early option to build a second carrier, CVN 69, because it could be started in Shipway 10 or Shipway 9 and then floated over to Shipway

11 when CVN 68 was launched. The Navy considered the claim statemen --"As originally planned when CVN 68 was launched, CVN 69 was planned to replace it in Shipway 11"--to be false.

The Navy also interpreted this claim language as holding the government to be contractually responsible for the decision to start CVN 69 in a smaller shipway. In its initial review, the Navy Claims Settlement Board and Admiral Rickover's staff assumed that NNS was claiming that the delay to the CVN 69 was caused, in part, by the delay in moving the CVN 69 to a large enough shipway that would permit construction to get under full swing. The Navy's analysis showed that the moving of the CVN 69 from one shipway to another did not impact its rate of construction. The problem was insufficient manning, which the Navy believes had nothing to do with delays on the CVN 68; and not the restrictions imposed by inadequate facilities. To sum up, the Navy's view was that it had nothing to do with the decision to begin the CVN 69 somewhere other than in Shipway 11 and that there was no original plan to begin construction of CVN 69 in Shipway 11. Hence, how could NNS reasonably claim that the Navy is contractually responsible for the facilities utilization problem and its consequences?

[redacted]

[redacted]

The matter does not end, however, with the realization that NNS is not asking for any money because of the shipway utilization problem. The Navy insists that the "as originally planned" language in the claim is false. Certainly, 18 U.S.C. §1001 could be used where 18 U.S.C. §287 does not apply.

[redacted]

[redacted]

Therein lies the heart of the dispute. The Navy interprets the phrase "as originally planned" as referring to formal construction schedules. Upon finding no such schedule calling for CVN 69 to immediately replace CVN 68 in Shipway 11 the Navy complains that it was the intended victim of a false representation.

[redacted]

[redacted]

In summary, extensive questioning [redacted] [redacted] d not establish any intent to mislead the Navy regarding the intended sequence of construction. [redacted] [redacted] Accordingly, the staff recommends that no prosecution be brought under either 18 U.S.C. §287 or 18 U.S.C. §1001.

7. CVN 69 Delay: Innerbottom Shieldings. In 1978 Willis responded to questions from the Navy Claims Settlement Board regarding the efforts of the shipyard to mitigate the effects of delay to the CVN 69. Included in his response was a memorandum of a conversation with the superintendent in charge of steel hull construction on the Eisenhower (CVN 69). The superintendent, Mr. Bradway, was quoted as saying that a Navy change order in the type of shielding to be used in the innerbottom surrounding the nuclear reactors on the CVN 69 was a primary cause of delay in the transfer of the CVN 69 from Shipway 9 to Shipway 11. Bradway said that the change in the type of shielding led to a holdup on innerbottom construction which in turn caused adjacent structural erection to slow and virtually come to a stop late in the summer of 1971. During this slowdown idle manpower was diverted to other projects, including the Nimitz, CVN 68. As a result, when the holdup on the innerbottom shielding was lifted by the Navy in September, 1971, Mr. Bradway said that he no longer

had sufficient manpower to make up for the lost time. Consequently, transfer of the CVN 69 from Shipway 9 to Shipway 11 had to be slipped from May, 1972 to September, 1972, a delay of five months. No compensation was requested for any delay in transfer due to a combination of the manpower and innerbottom shielding problems.

The reaction of Dave Leighton, Admiral Rickover's chief nuclear engineer for the aircraft carriers, upon receipt of the Bradway memorandum, was to label it a "fabrication". Leighton insists that the change in shielding which was directed by Admiral Rickover did not have any impact on adjacent non-nuclear erection work on CVN 69. Leighton also points out that NNS entered into contract modifications in 1971 and 1973 in which it acknowledged that the change in shielding would not delay delivery in the ship. Hence, any effort in 1978 to blame the holdup of innerbottom shielding for delay is both fraudulent and double-dipping.

Because this item appeared to have good potential for a fraud case, the staff devoted considerable resources to its investigation. For instance, the staff attorneys spent a great deal of time with Dave Leighton going over the documentation and receiving a crash course in the intricacies of nuclear aircraft carrier construction. With the assistance of Leighton, over 50 exhibits were prepared for use in grand jury sessions in cross-examining NNS personnel. [redacted].

It was thought that the shielding memorandum represented a prime example of overreaching if not outright fabrication in the claims efforts. Bradway did not write the memorandum. Rather, he was interviewed in December, 1977 regarding the matter by Eason and Chandler, Willis' chief assistant and the claims writer in charge of the CVN 68/69 claim. It was thought that either the interview never took place among Eason, Chandler and Bradway; or Eason and Chandler deliberately misquoted Bradway's recollection of the events of 1971 and 1972. According to the prosecution theory, in the closing months of claims negotiations Willis or Chandler found this memorandum and sent it in as part of a last ditch effort to bolster an otherwise weak and fraudulent CVN 69 claim. Hopefully, the government's ability to make a case on the shielding issue would unlock other fraudulent representations in the delay area.

[redacted]

It was thought that without reference to the memorandum in question, it could be independently established that the change in shielding had nothing to do with the pace of adjacent structural work on the carrier. The staff planned to work up the organizational structure from Bradway to the chief claims writers in an effort to determine how and by whom the basic facts were twisted or fabricated prior to submission of the "bogus" memorandum to the Navy.

[redacted]

[redacted]

[redacted]

[redacted]

The documents initially turned over to the staff by Leighton included some of the production control meeting minutes but not [illegible] ev though the missing minutes directly discussed the innerbottom shielding problem and were referred to in other documents turned over by Leighton. When confronted with these omissions, Leighton explained that he thought he had turned over all of the relevant minutes to the staff. When asked how he could reconcile his view of the impact of the shielding change with such contemporaneous documentation, Leighton explained that the meeting minutes were self-serving and not to be believed. According to Leighton, as long ago as 1971 and 1972 waterfront personnel were coming up with phony reasons for delays in the ship in order to coverup their own inefficiencies. In essence, Leighton considered any minutes written by Eason or other waterfront personnel in 1971 to be part of a continuing conspiracy to defraud the Navy which included what was later said about CVN 69 delay by the claims writers in 1977-1978.

[redacted] Leighton is correct that there was a tendency at the shipyard to exaggerate the impact of late delivery of nuclear components and of changes in nuclear design on construction of the carriers, submarines and cruisers. On the other hand, there was a tendency among Admiral Rickover's staff to minimize the impact of their failure to meet nuclear design deadlines, delivery dates, etc. Leighton's bias in 1978 was to minimize the impact of a change in shielding which he and Admiral Rickover had personally ordered and approved in 1971. [redacted] As is so often the case in the area of delay, the truth is probably somewhere in between the two positions. [redacted] It is also significant that one memorandum which Leighton failed to turn over to the staff states that Don Kane thought that the shielding change would delay construction of the CVN 69. Kane's credentials in this area are equal to Leighton's. Kane's integrity has not been undermined by the bitter contract dispute between the Navy and the shipyard which was the predicate for the filing of the CVN 68/69 claims.*

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*Even if Leighton was right [redacted] it is hard to see how the government could prove it. There is no available documentation detailed enough to demonstrate the inefficiency of Bradway's welders and other steel hull workers in 1971. Nor is there any documentation regarding the number of workers that Bradway rolled-back to the Nimitz when the shielding holdup problem arose. Leighton misses one other significant point in his analysis. It is of no consequence what the actual impact of the shielding change should have been on CVN 69 construction. [redacted]

In summary, Leighton's theory of a grand conspiracy dating back to 1971 cannot be sustained. [redacted]

Regarding the double-dipping aspect of this item--Leighton's second allegation--[redacted]

[redacted]

[redacted]

The above summary cannot really do justice to the issues involved. [redacted]

The controversy over the innerbottom shielding overlaps another issue of far greater importance to the resolution of the claims--manpower. The Navy considered the contractor to be entirely at fault for insufficient manning. The shipyard believed it had sufficient manpower to build the ships that were originally contracted for but not to build the ships eventually called for after Navy changes in design and added work. Each side to this fundamental dispute commissioned extensive studies to prove that the yard did or did not have sufficient manning. The results were inconclusive. [redacted] Rickover and others are quick to cite newspaper articles showing Diesel pleading for more manpower and complaining when the Norfolk Navy Shipyard hired away workers that NNS needed to complete the job. At one point Diesel advocated boosting the yard's labor force to 30,000 men. But when he realized that the figure could not be achieved without a drastic decline in productivity he gave up the goal and reduced the work force to around 20,000. The Navy takes this as strong proof that the manpower problem was caused by the contractor's mistakes. [redacted]

Like so many issues in the delay area, the manpower question is not subject to easy resolution. In fact, because of the difficulties of proof, both sides were interested in settling the claims rather than proving the manpower question before the ASBCA. If proof before the ASBCA would have been difficult, proof before a criminal forum would be next to impossible for this type of issue. As a general rule, the more necessary it becomes to reconstruct the history of the building of an aircraft carrier or a submarine from A-Z, the less likely it becomes that proof of a criminal conspiracy will emerge.

The innerbottom shielding issue is typical of most of the claim items referred to the staff for investigation in one other respect. Nearly all of the items identified as false or fraudulent by Leighton and Admiral Rickover concerned matters of judgement. Those matters usually included the degree of Navy responsibility, the extent of Navy-caused damages, the appropriateness of statistical methods used by the contractor, the interpretation of specifications, or the assessment of the scope of responsibility of the Navy's design agent, RPPY, under the contract with NNS.* Invariably, the judgment of Rickover's staff was that the Navy caused some damages but not as much damages as NNS claimed. Inevitably, such disputes pitted the judgment of one engineer working for Rickover against the judgment of another engineer working for NNS, with Kane usually in the middle. Where the disagreement was over an estimate of the quantum of delay, rather than whether any delay occurred or was caused by the Navy, the difficulties of proof were magnified.

There should be no misunderstandings, however, regarding the staff's willingness to tackle such technical issues even in areas involving engineering judgment. For example, if there had been fraud in the innerbottom shielding area, the staff was fully prepared to present such a case to a jury, even if it meant reconstructing events in 1971 and going into the intricacies of aircraft carrier construction. The staff's recommendation against prosecution has nothing to do with whether the matter is technical or not. [redacted]

8. Fictitious Manhours. The Bow Dome Report, Section V.A.2., discusses the allegation that NNS deliberately overstated the number of manhours worked or expected to be worked on the Navy ships. The allegation arose when it was discovered that the manhours in the claims plus the manhours already paid for in the contract (as adjusted by adjudicated change orders) exceeded by an average of 15 percent the number of manhours represented to be the Estimated Final Costs of construction in the

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*A substantial number of the referrals dealt with issues of contract construction. However, "one cannot be found guilty of a false statement under a contract beyond a reasonable doubt when his statement is within a reasonable construction of the contract." U.S. v. Race, Blocker and Leatherwood, __ F.2d __ (4th Cir.1980), Slip. Op. No. 78-5140 p. 14, September 25, 1980.

shipyard's Profit and Loss Statements.* For instance, regarding the SSN 688 Claim, the difference between the Profit and Loss statement figures and the figures in the contract (as adjusted by adjudicated change orders) and the claim are about 6.8 million manhours or around $70 million.

The extent of the staff's investigation of this allegation and the use of DCAA accountants to review shipyard financial records are detailed in the prior Bow Dome Report. In general, the staff was particularly concerned about two aspects of the shipyard's handling of manhour figures. First, were the calculations used in determining the value of delay, disruption, deferred work and deterioration of labor tampered with to meet pre-arranged target dollar figures? In other words, did Siefert's** calculations of delay and related costs have any integrity? Second, did NNS represent, in fact, that it was requesting compensation for manhours which it had never worked?

[redacted]

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*It is recommended that the reader review the discussion of the manhour allegations in Section V.A.2 in the Bow Dome Report prior to consideration of this supplemental memorandum.

**Siefert, a cost engineer, did all the pricing of these items.

One is also reminded that Siefert's figures are estimates, not hard calculations, and were so represented to the Navy. The Navy was free to reject these estimates of ripple-effect damages caused by Navy changes and added work. In fact, the Navy did reject them, coming up with its own independent analysis of the cost of delay, disruption, etc. That analysis was based in part on the subjective judgment of Navy analysts as to the consequences of Navy changes in ship construction and in part on computer models and projections.

Had there been an ASBCA hearing, each side would have probably labeled the other's calculations as absurdly low or high. In the realm of intangibles, like measuring the effect on productivity of Navy delays or the cost of resequencing work, one is far from the area of precise, measurable costs.

[redacted]

[redacted]

[redacted]

That was also how it was represented to the Navy. In other words, the Navy was told that the millions of dollars for delay and related costs were nothing more and nothing less than "pure judgment estimates" which the Navy was free to accept, reject, or calculate themselves according to their own independent analysis. [redacted]

[redacted]

A [redacted]

[redacted]

[redacted]

[redacted]

To prove fraud in the calculations, the government had to show they were either made in bad faith or represented to the Navy as being other than the best judgment of a cost engineer. The staff was unable to prove that the calculations were tampered with or that any misrepresentations were made to the Navy.

Regarding the second area of concern--whether NNS asked to be paid for fictitious manhours--[redacted]

In the final analysis the requested target cost figure in the claims which exceeded the Estimated Final Cost in the Profit and Loss Statements was nothing more and nothing less than a target to be used in drawing a new shareline under the Fixed Price Incentive Fee Contract. The new target cost did not represent a sum certain to be paid by the Navy. Any differences between the target and the Estimated Final Cost represented an equitable profit on the contract. In other words, NNS (i.e. Willis) told the Navy that the difference was equal to the percentage amount of hours or dollars by which NNS would have underrun the original target cost had there been no Navy delays and changes in the scope of work.

The Navy may not and certainly does not agree with this "underrun" pricing theory. But the Navy cannot claim that Willis misrepresented in his Proposals for Equitable Adjustment the true costs (as stated in the Profit and Loss statements) of construction. For these reasons, the government cannot show any intent to defraud the Navy or to be paid for fictitious manhours.

9. Prearranged Target Values. The Bow Dome Report, Section V.A.3., discusses the allegation that NNS decided in advance that it needed to net around $200 million in cash from the claims and inflated them accordingly. The $200 million figure worked out to around $600 million in adjustments in target cost. According to this allegation, the chief claim writers must have met in advance of the research effort to establish dollar targets for each of the Proposals. Pressure would then have been exerted on lower-level employees to come up with enough claim items to

meet the dollar target. The targets would have dictated or influenced what was written about each claim item and how it was priced by the Cost Engineers.

According to these allegations, top management controlled the pricing effort, exerting pressure on Willis and Adams, head of Cost Engineering, to come up with the dollars, no matter what the true facts regarding Navy responsibility were. The motive was simple. NNS needed to book a high enough asset value for the claims on its Profit and Loss Statements to get the company out of the red. In support of this allegation, it was known that John Diesel, president of NNS, had stated in late 1973 or early 1974 that the claims would be worth $200 million to the company. This figure was very close to the $189 million that the company eventually recovered by way of settlement in October of 1978.

The staff was unable to prove any aspect of this allegation. There was no link between Diesel's statements and the manner by which the claims were researched and written. No $200 million asset value was booked by NNS in advance of the claims writing effort. [redacted]

[redacted]

[redacted]

[redacted]

[redacted] If anything, the claims effort was decentralized and fragmented to avoid such suspicion.

[redacted]

[redacted] Analogy can be made to the ABSCAM cases. Unlike the Congressmen who were unaware of the government's surveillance techniques, Willis knew he was being watched. And just as the Congressmen would not have taken any money if they knew they were being videotaped, Willis was going to be careful not to open himself up to unnecessary attack by his actions.

It did not take long before the first confrontation occurred. In October, 1974 Willis wrote a letter to the Navy presenting a matrix or outline of the general subject areas to be covered by the claims--delay, disruption, design defects, etc. No dollar figures were mentioned. Rickover got ahold of the letter, asked Senator Proxmire to convene congressional hearings, and introduced the letter as an example of how unreasonable the shipbuilders were; and of how they were already getting claims together to cover their tracks. [redacted]

[redacted] Unlike antitrust bid rigging cases in which phony cost estimates, meetings among conspirators, or a falling-out among competitors sooner or later gives away the artificial nature of the bids, there are no such tell-tale signs in the shipbuilding case. Moreover, the decentralization and fragmentation of the claims effort, and the manner in which the claims were put together, and Willis knowledge that his every move was reported back to Admiral Rickover, made a conspiracy unlikely. In any event, the staff, regardless of their personal beliefs concerning the existence or non-existence of a scheme to rig the claims, has not found any proof thereof.

[redacted]

[redacted]

them as written and did not question the rationale or calculations of the estimates. According to Willis, there was no tampering with or revisions of Adams' workproduct by Willis or by his subordinates. Finally, Willis said that he did not give Adams a target to shoot for and wasn't aware of anyone else giving him one. As previously stated, the staff was unable to come up with any evidence to rebut the assertions of Willis, Diesel, Adams or anyone else regarding the integrity of the pricing effort.

[redacted]

[redacted]

[redacted]

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*Each claim was composed of between 25 and 50 items, which were separately priced.

[redacted]

Finally, in addition to the factors discussed herein, there is one area of general importance to the issue of a conspiracy to arrive at a pre-arranged dollar figure in the claims. [redacted] Because 80 percent or more of each of the claims asked for reimbursement for intangibles like deterioration of labor or disruption, both sides knew that such dollar figures were relatively unimportant. What counted was the persuasiveness of the narrative and its explanation for why the Navy should be responsible for delay or disruption. As Gil Cuneo, former General Counsel for the Navy and for many years a prominent government contracts lawyer stated, there was no way that the Navy was going to pay 100 percent of the estimated cost for an item like deferred work. Any dollar figures in the claims, even figures in the tens of millions of dollars, were ballpark estimates and only starting points for negotiations. True, the figures were the best judgment of the estimator but nobody was going to pay any money on the basis of that judgment.

The point of all this discussion concerning the estimates is fairly simple. The more important a precise dollar figure becomes, the more likely the existence of a conspiracy to rig that figure. Conversely, the less important a dollar figure really is, the less the necessity to rig it. For instance, in the road construction industry, contractors rig bids because contracts are awarded to the lowest bidder. But with NNS, the company did not need to fabricate the loose estimates presented to the Navy since both sides knew they would never be the basis of payment by the government.

10. Other Items. Not discussed in this memorandum are about twenty other claim items which the staff found to have little or no potential for a fraud prosecution. Some of these items were originally referred by the Navy to the Department of Justice; others were developed in the course of the grand jury investigation. All were analyzed from a technical point of view by the engineers or accountants assisting the prosecution team. In all cases the staff either found no false representations or no evidence of deliberate misstatements. [redacted] All were investigated by the FBI, who conducted numerous field interviews. The items include, among others: MSW Valves (SSN 688); Platforms (SSN 688); SSN 688 Delay; On Board Stowage (CGN 38); Interest and Added Financing Costs (all ships); SAPS, MUDUPS, LPSS, NDRS (CVN 68); and Manpower (all ships).

11. Proof of Intent. Very early in the investigation, two former NNS employees (who had minor roles in the claims writing effort) told the staff that at an organizational meeting they were told to ask for twice as much money as the shipyard was entitled to because the Navy would only pay $.50 on the dollar. [redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted] At least a handful of claim items among the 300 submitted to the Navy showed a lack of attention to detail or sloppiness which indicated that the claims writer was satisfied if he had presented a colorable argument for compensation backed up by only a few of the necessary facts. Quality was uneven and some items were clearly part of a "rush" job.

But such evidence does not amount to proof of the requisite intent for a criminal prosecution. [redacted] It also means that there are very few hard facts which a prosecutor can seize upon as inaccurate representations indicative of an intent to defraud the government.

[redacted]

In retrospect, there were perhaps three factors which made a criminal conspiracy unlikely. First, Willis was not going to deliberately misrepresent material facts with Admiral Rickover looking over his shoulder at every stage of the claims process.

Second, the claim structure itself made it difficult for the pricing of the items to be influenced by what the claims writers thought the Navy was entitled to. The more decentralized and fragmented the effort, the more difficult it was to conduct a successful conspiracy. Third, NNS did not need to misrepresent any hard data to obtain a successful settlement in adjustment of its Navy contracts. Eighty percent of the claims were made up by items like delay, disruption and related costs. These items were impossible to precisely quantify. Willis did not have to try to quantify them. All he had to do was present colorable arguments backed up by the subjective judgments of his estimators in order to work out a successful settlement. And so long as he told the Navy that his figures were estimates and that his arguments were based on theories, no one was misled or defrauded.

In conclusion, the staff found no evidence of intent to defraud, only a few instances of factually false representations, and little or no evidence of factors conducive to formation of a criminal conspiracy. Neither the big theory--fictitious manhours, prearranged target figures--or the smaller theory of a pattern of false items pyramiding into a general scheme to defraud held together. For the reasons stated in the earlier Bow Dome Report, Section V, and in this Supplemental Memorandum, the undersigned recommends that prosecution be declined.

Eliot Norman

Eliot Norman
Assistant United States Attorney

SAMPLE PAGES FROM
CVN 68 DELAY CLAIM

4.1.1 Government Responsible Delay - USS NIMITZ (CVAN68)

As previously stated, delivery of the USS NIMITZ was delayed 123 days based on the contractual delivery date of December 9, 1974. Delivery was made on April 11, 1975. The following discussion will demonstrate Government responsibility for the entire 123-day period. The delays addressed relate to specific reactor plant acceptance test program events, and to other events resulting from Government operator actions and software problems which cumulatively impacted delivery.

The base point for calculating the required adjustment to the delivery date is taken from Contract Modification Number A1018 dated February 12, 1973, which established a delivery date of December 9, 1974. (This date was specified on the maximum delay due to Headquarters Modification Requisition Number 81.)

To comprehend the specific impact each Government responsible action had on the delivery schedule, it is necessary to understand the basic mandatory sequence of nuclear construction and testing. In the instant case, this sequence is as follows:

- Vessel (Hull Structure and Outfitting) Construction.
  Figure 4.1-4 displayed the general building-yard life of a nuclear surface vessel. The nuclear propulsion plants of the USS NIMITZ required the longest construction and testing time because of their complexity; hence, the controlling sequence follows this schedule.
- Reactor Plant Construction and Testing.
  This sequence may best be presented graphically. Figure 4.1-7 displays this sequence. Subsequent to laying the ship's keel, a major portion of the building program was the construction of

EXHIBIT
M/2R Ex
2

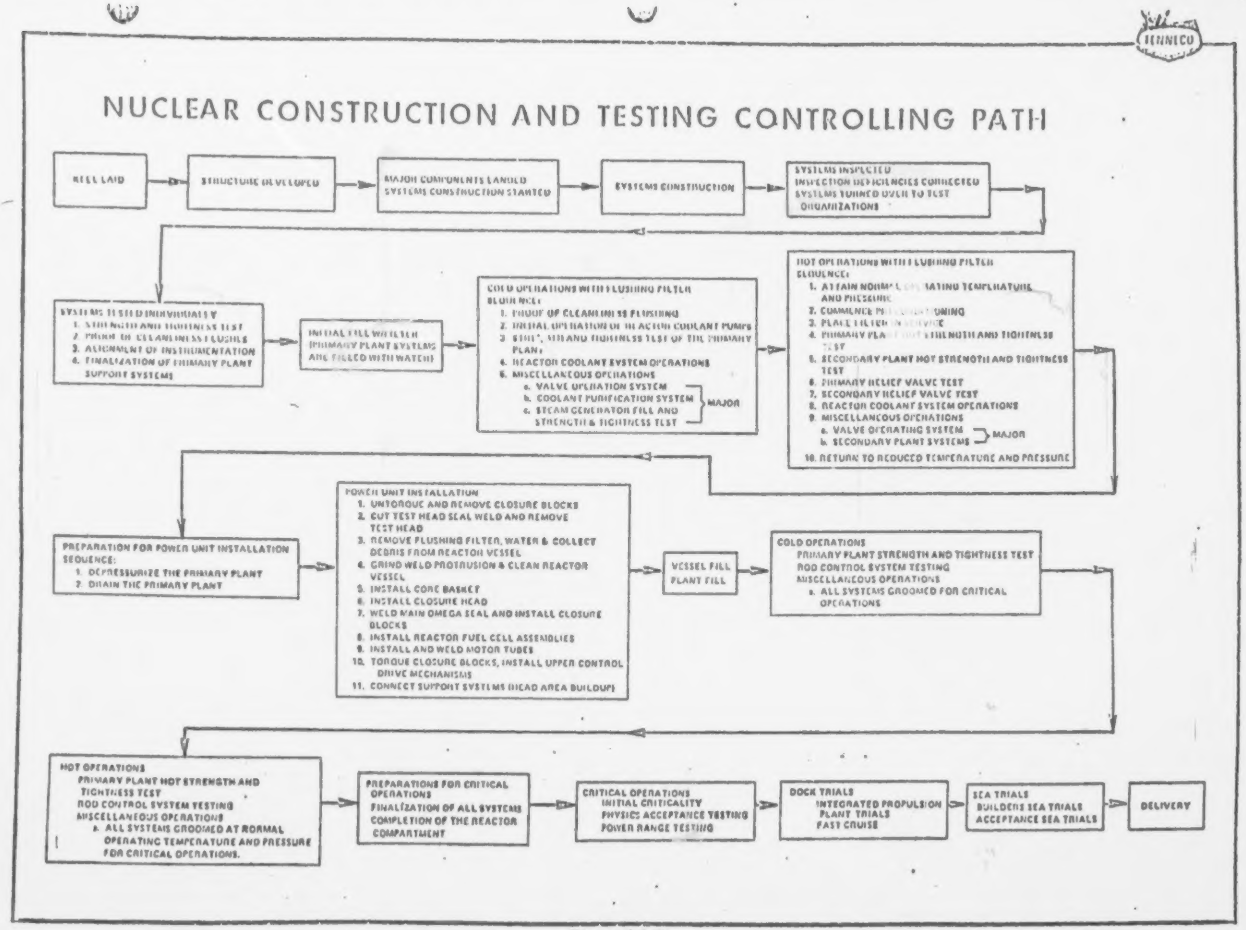
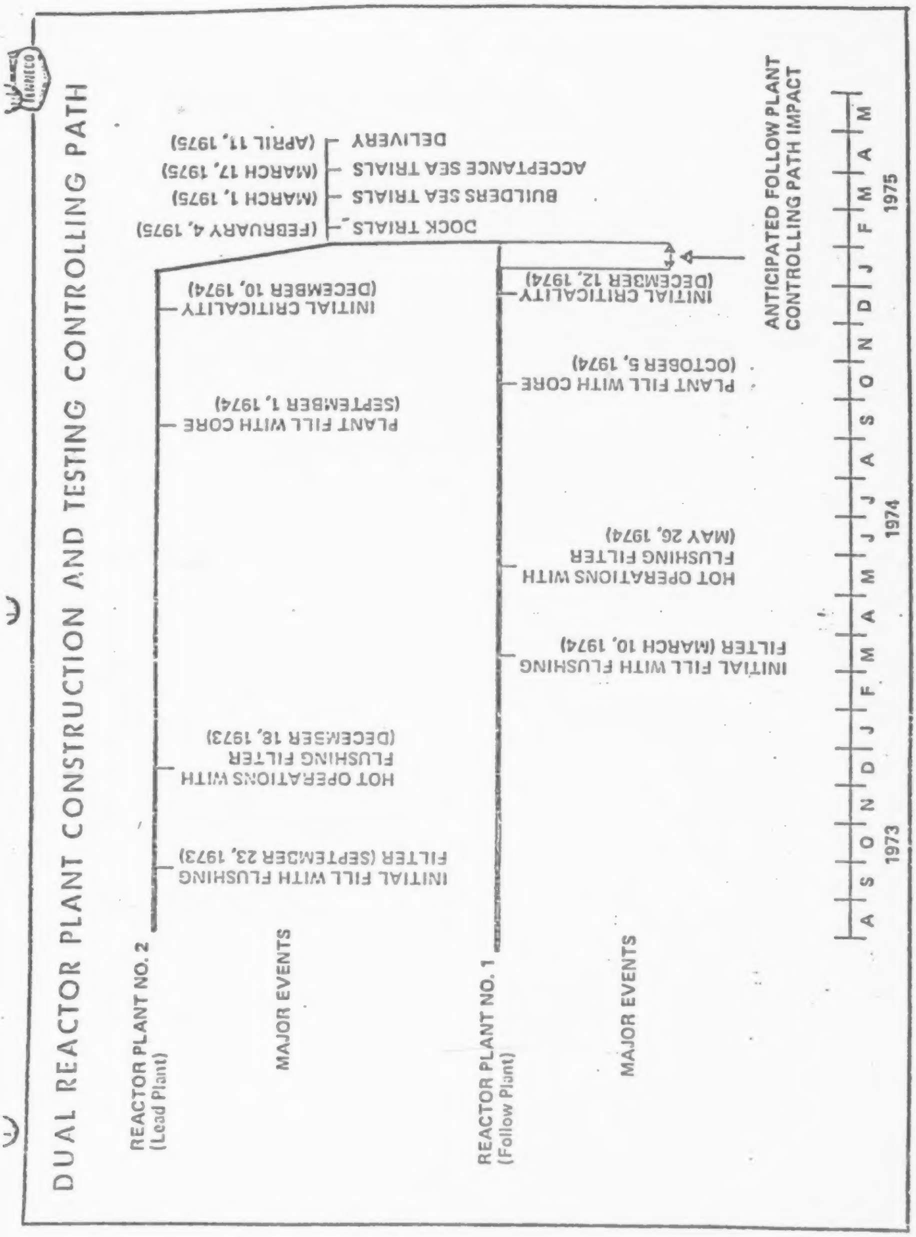

TENNECO
NUCLEAR CONSTRUCTION AND TESTING CONTROLLING PATH
KEEL LAID
STRUCTURE DEVELOPED
MAJOR COMPONENTS LANDED
SYSTEMS CONSTRUCTION STARTED
SYSTEMS CONSTRUCTION
SYSTEMS INSPECTED
INSPECTION DEFICIENCIES CORRECTED
SYSTEMS TURNED OVER TO TEST ORGANIZATIONS
SYSTEMS TESTED INDIVIDUALLY
1. STRENGTH AND TIGHTNESS TEST
2. PROOF OF CLEANLINESS FLUSHES
3. ALIGNMENT OF INSTRUMENTATION
4. FINALIZATION OF PRIMARY PLANT SUPPORT SYSTEMS
INITIAL FILL WITH FILTER (PRIMARY PLANT SYSTEMS ARE FILLED WITH WATER)
COLD OPERATIONS WITH FLUSHING FILTER SEQUENCE:
1. PROOF OF CLEANLINESS FLUSHING
2. INITIAL OPERATION OF REACTOR COOLANT PUMPS
3. STRENGTH AND TIGHTNESS TEST OF THE PRIMARY PLANT
4. REACTOR COOLANT SYSTEM OPERATIONS
5. MISCELLANEOUS OPERATIONS
a. VALVE OPERATION SYSTEM
b. COOLANT PURIFICATION SYSTEM
c. STEAM GENERATOR FILL AND STRENGTH & TIGHTNESS TEST
MAJOR
HOT OPERATIONS WITH FLUSHING FILTER SEQUENCE:
1. ATTAIN NORMAL OPERATING TEMPERATURE AND PRESSURE
2. COMMENCE PRECONDITIONING
3. PLACE FILTER IN SERVICE
4. PRIMARY PLANT HOT STRENGTH AND TIGHTNESS TEST
5. SECONDARY PLANT HOT STRENGTH AND TIGHTNESS TEST
6. PRIMARY RELIEF VALVE TEST
7. SECONDARY RELIEF VALVE TEST
8. REACTOR COOLANT SYSTEM OPERATIONS
9. MISCELLANEOUS OPERATIONS
a. VALVE OPERATING SYSTEM
b. SECONDARY PLANT SYSTEMS
MAJOR
10. RETURN TO REDUCED TEMPERATURE AND PRESSURE
PREPARATION FOR POWER UNIT INSTALLATION SEQUENCE:
1. DEPRESSURIZE THE PRIMARY PLANT
2. DRAIN THE PRIMARY PLANT
POWER UNIT INSTALLATION
1. UNTORQUE AND REMOVE CLOSURE BLOCKS
2. CUT TEST HEAD SEAL WELD AND REMOVE TEST HEAD
3. REMOVE FLUSHING FILTER, WATER & COLLECT DEBRIS FROM REACTOR VESSEL
4. GRIND WELD PROTRUSION & CLEAN REACTOR VESSEL
5. INSTALL CORE BASKET
6. INSTALL CLOSURE HEAD
7. WELD MAIN OMEGA SEAL AND INSTALL CLOSURE BLOCKS
8. INSTALL REACTOR FUEL CELL ASSEMBLIES
9. INSTALL AND WELD MOTOR TUBES
10. TORQUE CLOSURE BLOCKS, INSTALL UPPER CONTROL DRIVE MECHANISMS
11. CONNECT SUPPORT SYSTEMS (HEAD AREA BUILDUP)
VESSEL FILL
PLANT FILL
COLD OPERATIONS
PRIMARY PLANT STRENGTH AND TIGHTNESS TEST
ROD CONTROL SYSTEM TESTING
MISCELLANEOUS OPERATIONS
a. ALL SYSTEMS GROOMED FOR CRITICAL OPERATIONS
HOT OPERATIONS
PRIMARY PLANT HOT STRENGTH AND TIGHTNESS TEST
ROD CONTROL SYSTEM TESTING
MISCELLANEOUS OPERATIONS
a. ALL SYSTEMS GROOMED AT NORMAL OPERATING TEMPERATURE AND PRESSURE FOR CRITICAL OPERATIONS.
PREPARATIONS FOR CRITICAL OPERATIONS
FINALIZATION OF ALL SYSTEMS
COMPLETION OF THE REACTOR COMPARTMENT
CRITICAL OPERATIONS
INITIAL CRITICALITY
PHYSICS ACCEPTANCE TESTING
POWER RANGE TESTING
DOCK TRIALS
INTEGRATED PROPULSION PLANT TRIALS
FAST CRUISE
SEA TRIALS
BUILDERS SEA TRIALS
ACCEPTANCE SEA TRIALS
DELIVERY

Figure 4.1-7

> the reactor plants. Progress on this portion of construction can be seen in the completion dates of major construction and testing events, each of which had its own major sub-elements. These series of events culminated with acceptance sea trials and delivery. (In the following subsections, Government responsibility for delay during each of these major events will be demonstrated.)
>
> The USS NIMITZ is a two reactor ship. The No. 2 reactor plant was designated the "lead" plant and the problems of resolving material and procedural problems and difficulties during the construction and test program bore more heavily on that plant than on the No. 1 plant. The No. 1 or "follow" reactor plant duplicated the lead plant construction sequence in a shorter overall time period, having benefitted from experience gained on the No. 2 plant.

This dual sequence of construction is shown by Figure 4.1-8, which confirms that the lead plant was always the sequence which controlled vessel delivery. This two plant construction and testing schedule is common to two-reactor ships and was experienced during construction of both the USS CALIFORNIA (DLGN36) and USS SOUTH CAROLINA (DLGN37) which were recently delivered to the Government by the Contractor. The establishment of the lead plant as the controlling influence on CVAN68 delivery provides the basis for identifying the effect of schedular disruption and delay to the delivery date. Whenever a delay to the construction and testing sequence occurred, a resulting impact on the vessel delivery occurred.

The following is a list of the major events in the reactor plant acceptance test program. It was during the performance of thes major events



DUAL REACTOR PLANT CONSTRUCTION AND TESTING CONTROLLING PATH

Figure 4.1–8

that Government responsible delay to vessel delivery occurred.

- Initial fill of the primary systems and cold operations with the flushing filter.
- Preparation for hot operations.
- Hot operations with flushing filter.
- Preparation for power unit installation.
- Power unit installation.
- Primary system fill and cold operations with power unit installed.
- Hot operations with power unit installed.
- Preparation for initial criticality and power range testing.
- Initial criticality and power range testing.
- Government Operator Action and Software Problems.

Figure 4.1-9 presents the delay assessment associated with the reactor plant acceptance test program. A chronological narrative of specific delaying events follows which when used with Figures 4.1-8 and 4.1-9 provides the rationale for fair and equitable adjustment to the contract delivery date. It is noted that delay associated with proposal Sections 4.1.1.1 through 4.1.1.9 on Figure 4.1-9 actually total 159.7 days and is rounded off to a total program delay of 160 days.

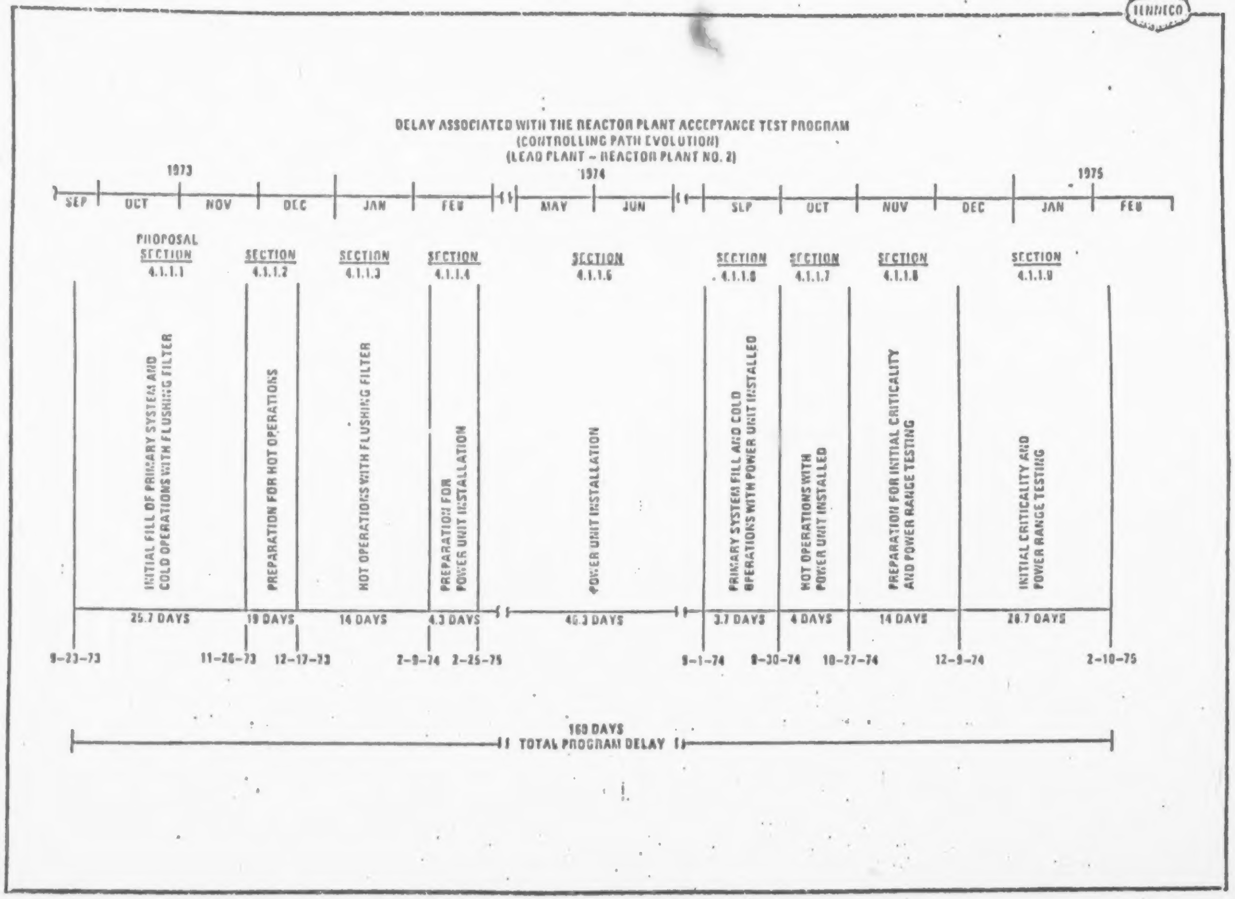

DELAY ASSOCIATED WITH THE REACTOR PLANT ACCEPTANCE TEST PROGRAM
(CONTROLLING PATH EVOLUTION)
(LEAD PLANT – REACTOR PLANT NO. 2)
1973
1974
1975
SEP
OCT
NOV
DEC
JAN
FEB
MAY
JUN
SEP
OCT
NOV
DEC
JAN
FEB
PROPOSAL SECTION 4.1.1.1
INITIAL FILL OF PRIMARY SYSTEM AND COLD OPERATIONS WITH FLUSHING FILTER
25.7 DAYS
SECTION 4.1.1.2
PREPARATION FOR HOT OPERATIONS
19 DAYS
SECTION 4.1.1.3
HOT OPERATIONS WITH FLUSHING FILTER
14 DAYS
SECTION 4.1.1.4
PREPARATION FOR POWER UNIT INSTALLATION
4.3 DAYS
SECTION 4.1.1.5
POWER UNIT INSTALLATION
46.3 DAYS
SECTION 4.1.1.6
PRIMARY SYSTEM FILL AND COLD OPERATIONS WITH POWER UNIT INSTALLED
3.7 DAYS
SECTION 4.1.1.7
HOT OPERATIONS WITH POWER UNIT INSTALLED
4 DAYS
SECTION 4.1.1.8
PREPARATION FOR INITIAL CRITICALITY AND POWER RANGE TESTING
14 DAYS
SECTION 4.1.1.9
INITIAL CRITICALITY AND POWER RANGE TESTING
28.7 DAYS
9-23-73
11-26-73
12-17-73
2-9-74
2-25-75
9-1-74
9-30-74
10-27-74
12-9-74
2-10-75
160 DAYS
TOTAL PROGRAM DELAY

Figure 4.1-9

~~is undeniable that such a significant quantity of problems, over 27,000, must have had a significant impact on construction and testing schedules and ultimately on ship delivery.~~

To summarize, the foregoing analysis has demonstrated and documented ernment responsible delays to the reactor plant acceptance test program. ys encountered occurred between September 23, 1973 and February 9, 1975. itulation of the events and corresponding delays follows:

Section 4.1.1.1	
Initial fill of primary systems and cold operations with flushing filter.	25.7 days
Section 4.1.1.2	
Preparation for hot operations.	19.0 days
Section 4.1.1.3	
Hot operations with flushing filter.	14.0 days
Section 4.1.1.4	
Preparations for power unit installation.	4.3 days
Section 4.1.1.5	
Power Unit Installation	46.3 days
Section 4.1.1.6	
Primary systems fill and cold operations with power unit installed.	3.7 days
Section 4.1.1.7	
Hot operations with power unit installed.	4.0 days

Section 4.1.1.8

Preparation for initial criticality and power range testing.	14.0 days

Section 4.1.1.9

Initial criticality and power range testing.	28.7 days
Total Delay (Reactor plant acceptance test program)	159.7 days (Say 160 days)

Delays resulting from improper Government operator actions and soft- re problems, while significant, have not been added to the 160-day delay sessment. Since improper Government operator actions and software problems curred concurrent with the delays discussed in the delay chronology, it only rengthens or augments the 160-day delay assessment derived above.

Through the efforts of experienced Contractor construction and test- ; supervisory personnel and by the optimum utilization of available labor and erial resources, the Contractor was able to improve on the time that should e been required to complete and deliver the ship. A calculated 160-day ay in vessel delivery was reduced to an actual 123-day delay as a result of intense and continuous efforts of the Contractor. Therefore, based on the ented evidence discussed in this analysis, the Contractor hereby requests 23-day adjustment to the contract delivery date of the USS NIMITZ as a ect result of Government responsible causes. More specifically, from mber 9, 1974 to April 11, 1975.

EXHIBIT S

JANUARY 23, 1981 -- LETTER FROM UNDERCOFLER TO RENFREW

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CABLE ADDRESS REYKAL TELEX 83-1320
TELECOPIER 215-546-3010

RICHARDSON DILWORTH
1898-1974
HENRY D. PAXSON
1904-1978
RICHARD L. LEVY
1911-1979

W A. KALISH
B A. SUTTON
S L. WHITMAN
J. HENRICH, JR.
ARD J. COOK
J. REESE, JR.
HEN J. HARMELIN
AN M. LOEV
WEISS
ARD F. MANNING
J. PICOTTE, II
ARD L. BAZELON
M. HANZELIN
AS E. DORAN
C. KAUFFMAN
EN J. MATHES
PHILIP CRAMPTON
NCE D. BERGER
J. MOSES
R. LATOURETTE, JR.
F. WOOD

C. LEO SUTTON
MARCUS MANOFF
STEPHEN J. KORN
SOLOMON FISHER
RICHARD J. GORDON
ROBERT W. MARIS
JOSEPH H. JACOVINI
JOHN M. FITZPATRICK
DAVID M. PITTINSKY
JOHN M. ELLIOTT
EDWIN M. GOLDSMITH, III
JEFFREY A. LESS
JOHN F. SMITH, III
RICHARD S. MEYER
THEODORE A. YOUNG
SAMUEL W. MORRIS, JR.
STEVEN L. FRIEDMAN
MICHAEL L. BROWNE
RICHARD M. SEGAL
BERNARD E. ZBRZEZNJ

CONSTANCE B. FOSTER
JAMES R. ROLLER
RICHARD H. LERCH
WILLIAM J. WINNING
J. JUSTIN BLEWITT, JR.
GARY R. LEADBETTER
RICHARD D. SPIEGELMAN
SHERYL L. AUERBACH
MARC A. FELLER
KAREN MAREK McALINN
CAROL A. MEEHAN
MARK J. LEVIN
LAWRENCE G. McMICHAEL
WILLIAM W. WARREN, JR.
STEPHEN C. BRAVERMAN
HENRY F. SIEDZIKOWSKI
MARIAN B. BUCCAFURNI
MARGUERITE A. SIVAK

CARL E. ROBERTS
JOHN F. STOVIAK
JAMES F. MONTEITH
ALAN J. HOFFMAN
NANCY AKBARI
RICHARD B. BISHOP
THOMAS J. ELLIOTT
LOUIS B. KUPPERMAN
THOMAS J. BENDER, JR.
RAFAEL A. PORRATA-DORIA
HOPE A. COMISKY
WILLIAM R. LEVY
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JOSEPH P. DOUGHER
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HENRY M. NASSAU
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BENJAMIN R. JONES
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ROBERT P. CASEY
DANIEL E. BEREN
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PENN SECURITY BANK BUILDING
SCRANTON, PENNSYLVANIA 18503
(717) 346-7569

[illegible] LOCUST COURT BUILDING
HARRISBURG, PENNSYLVANIA [illegible]
[illegible]

[illegible] BUILDING WEST
[illegible] STREET, N.W.
WASHINGTON, D.C. [illegible]
[illegible]

January 23, 1981

BY HAND

RECEIVED
JAN 29 2 17 PM '81
US ATTORNEY'S OFFICE
ALEXANDRIA, VIRGINIA

The Honorable Charles B. Renfrew
Deputy Attorney General
Department of Justice
Tenth and Constitution Avenue, N.W.
Room 4109
Washington, D.C. 20530

Dear Sir:

This firm represents Newport News Shipbuilding & Drydock Company ("Newport News") and certain of its employees in connection with a grand jury investigation which was conducted in the Eastern District of Virginia, Richmond Division. The investigation involved five requests for equitable adjustment to ship construction contracts submitted by Newport News to the Department of the Navy during the period June 1973 to March 1976. The requests, which were submitted pursuant to the terms of six ship construction contracts Newport News entered into with the Navy during the years 1967 to 1971, called for the equitable adjustment of the price and delivery schedules of fourteen nuclear powered warships built by Newport News on account of Navy actions or failures to act which were compensable under the terms of the contracts.

The investigation of Newport News began in August of 1977 as a joint effort by Departments of Justice attorneys and Navy attorneys assigned to the Office of General Counsel of the Navy. On February 6, 1978 a formal referral of the investigation was made to the Department of Justice by the Navy's Office of General Counsel. From February 1978 to October 1978 Department of Justice attorneys, together with a number of Navy attorneys, conducted an investigation of the requests for equitable adjustment submitted by Newport News. In October 1978 a grand jury investigation was convened before a grand jury sitting in Richmond, Virginia. This grand jury was specifically empanelled to investigate the requests submitted by Newport News to the Navy. For eighteen months, the grand jury, under the direction of the United States Attorney's Office in Richmond, Virginia considered the matter and during that period of time no less than twenty-six subpoenas duces tecum were issued to Newport News requiring the production of extremely voluminous corporate documents and records. In addition, in excess of seventy current and former employees of Newport News were subpoenaed before the grand jury and/or were interviewed by special agents of the FBI or agents employed by the Naval investigative services. Pursuant to an order of the Honorable Robert R. Merhige dated April 10, 1980, the initial grand jury expired with no charges having been brought against the company or any of its employees.

Thereafter, a successor grand jury was utilized to conduct further investigation. The successor grand jury issued subpoenas to additional persons in furtherance of the investigation and their testimony was taken before the successor grand jury in June of 1980. It is our understanding that following the testimony before the successor grand jury in June 1980 the investigative team which consisted of a Department of Justice attorney assigned to the fraud section, an assistant United States attorney in the Richmond United States Attorney's Office, and two Navy attorneys, all of whom had been substantially involved in the investigation, made recommendations to terminate the investigation without the filing of any charges. In this regard, we were advised that these recommendations would be subject to review by the United States Attorney for the Eastern District of Virginia and thereafter the Department of Justice. From June 1980 until January 1981, there was no indication to Newport News or anyone else involved in the investigation that the investigation was other than finally concluded. In fact, a substantial majority of documents produced by Newport News to the government during the course of the investigation was returned to Newport News.

On January 19, 1981 we were advised that a decision had been reached by the United States Attorney's Office in Alexandria, Virginia to re-open the investigation. We were further advised that subpoenas were being issued for a three day grand jury session to begin on February 3, 1981 in Alexandria, Virginia. In addition, we were advised that documents would again be subpoenaed from Newport News for purposes of this investigation. The documents to be subpoenaed are those same documents that were returned to Newport News by the government at the conclusion of the previous investigation.

Further inquiry revealed that the recommendations of the investigative team had not been considered by the Department of Justice, but that the decision to reinvestigate had been reached by the United States Attorney's Office in Alexandria.

Because of the serious and substantial impact the reinstitution will have upon Newport News and its ability to carry forward its mission as the principal builder of Navy warships, we respectfully request that the Department of Justice agree to review the decision of the United States Attorney's Office for the Eastern District of Virginia to begin the investigation anew before any additional investigation takes place. Because of the extensive investigation which was conducted from 1977 through June 1980, and the resulting recommendations, we believe that the Department of Justice should fully review the decision to re-open the investigation.

In addition, Newport News requests the opportunity to submit to the Department of Justice a detailed memorandum setting forth its position as to why an investigation should not again go forward. In essence, Newport News has already been the subject of an intensive and disruptive investigation lasting in excess of four years conducted by attorneys and agents who have diverted countless hours in the analysis of documents and in the interrogation of witnesses. We believe their joint recommendation to conclude the investigation should carry great weight and that at some point exhaustive investigations which disrupt the morale and ability of a company to perform its essential functions should cease. Accordingly, we believe it is in the best interests of all concerned that there be a full review of the decision to re-open the investigation before Newport News and its employees are again subjected to the disruption, expense, and anxiety of another grand jury investigation.

We would welcome an opportunity to meet with the appropriate officials of the Department of Justice as soon as possible to discuss this matter and we are prepared to submit promptly a memorandum outlining our position in detail.

Respectfully yours,

J Clayton Undercofler

J. Clayton Undercofler, III

dc
cc: John C. Keeney, Esq.
Eliot Norman, Esq. ✓

EXHIBIT T

NOVEMBER 2, 1981 -- WHITE COLLAR CRIME PRIORITIES, EASTERN DISTRICT OF VIRGINIA

Memorandum

Subject Eastern District of Virginia
White Collar Priorities

Date

To Elsie Munsell
United States Attorney
Eastern District of Virginia

From JAF Joseph A. Fisher, III
Chief, Fraud and Corruption Div.

Our District's White Collar Crime Priorities are set forth on page 2 of Tab F. Federal procurement fraud in various of its permutations and combinations receive top billing as you might well have expected, since historically and presently this has been an area of intense activity, especially in the Alexandria and Norfolk divisions. A statement as to how these priorities came to be set is in order.

On September 9, 1980, Attorney General Civiletti wrote to all United States Attorneys directing that they prepare district-wide priorities in the area of white collar crime and corruption. See Tab A. As detailed in Attorney General Civiletti's letter, the purpose for this effort was directed toward utilizing ". . . scarce investigative and prosecutive resources in the most effective manner".

On October 31, 1980 we filed with Deputy Attorney General Renfrew a list of our priorities. See Tab B. Our listing of priorities was no willy-nilly response to a department "paper shuffle ". It reflected a careful analysis of then existing investigations and cases either under indictment or recently concluded. Our comments appearing on page 2 of Tab B regarding the unique nature of our district are still valid.

On December 12, 1980, during the final days of the Carter administration, Jack Keeney, writing for Assistant Attorney General Heyman, noted that our priorities ". . . demonstrate[d] a great deal of thought and work by you [Justin] and your colleagues " but suggested that perhaps our expectations were bigger than our existing manpower resources could hope to accomplish. See Tab C. Mr. Keeney's suggestions were detailed and in my view realistic. Because of the press of cases, etc., we never got around to paring down and refocusing our priorities until this past summer, after Mr. Keeney wrote a reminder to us on June 19, 1981, emphasizing Assistant Attorney General Jensen's ". . . keen interest in the Department's efforts to combat white collar crime . . ." and ". . . his commitment to the full and expeditious implementation of the white collar crime priorities initiative". See Tab D. We responded to Mr. Keeney's letter on July 13, 1981 (see Tab E), werein we shortened our list of District'wide priorities.

In a memo dated August 21, 1981, Tab F, we received from Associates Attorney General Guiliani approval of our shortened list of priorities, which was also concurred in by Mr. Jensen.

TAB A

Memorandum

CC: Joe Fisher - Fraud
Richmond - Fraud Sect.
Norfolk - Fraud Sect.

RECEIVED
SEP 11 11 09 AM '80
U.S. ATTORNEY'S OFFICE
ALEXANDRIA, VIRGINIA

Subject
National Priorities for the Investigation and Prosecution of White Collar Crime

Date
September 9, 1980

To All United States Attorneys

From Benjamin R. Civiletti
The Attorney General

Pursuant to my authority and responsibility as the federal government's chief law enforcement official, I am today announcing national priorities for the investigation and prosecution of white collar crime. Those priorities, which are effective immediately, are described in the attachments to this memorandum.

As you may know, these priorities were developed over the past eight months on the basis of information concerning white collar crime activity provided by law enforcement agencies throughout the federal government. Thanks to the excellent cooperation we received from all sectors of the federal law enforcement community, we now have a much more comprehensive picture of the types of white collar crime and corruption activity occuring across the country and their magnitude.

I have asked the Deputy Attorney General, with the assistance of the Criminal Division and the Executive Office for United States Attorneys, to coordinate the implementation of the national priorities and the definition of specific district priorities within the national priorities for a number of districts. I have asked him to report to me on a monthly basis concerning this project. I encourage each of you to work closely with the federal investigative agency field offices and the Economic Crime Unit, if there is one, within your district in implementing these national priorities and to use this initiative as an opportunity to coordinate and enhance federal law enforcement efforts directed toward white collar crime within your district.

The development of national and district law enforcement priorities in the area of white collar crime and corruption is an important step in making certain that we use our scarce investigative and prosecutive resources in the most effective manner. However, the development of priorities is only one of a number of necessary steps. We must all devote our energies to making those priorities meaningful. Your role in making these priorities work is critical. With your support and with the continuation of the cooperative spirit within the federal law enforcement community that has typified this initiative thus far, I am confident that a year from now, or perhaps sooner, we can report to Congress and the American people significant progress in preventing and curtailing the incidence of major white collar crime.

September 9, 1980

FACT SHEET

National Priorities for the Investigation and Prosecution of White Collar Crime: Report of the Attorney General

Basis of Priorities

Information concerning white collar crime activity was collected and analyzed by the Criminal Division, U.S. Department of Justice, from December 1979 to July 1980.

Criteria for Defining Priorities

- Pervasiveness of the illegal activity
- The immediate victims and their losses
- Indirect or secondary victims and their losses
- People and institutions involved as perpetrators or accomplices
- Connection with organized crime or other criminal activity
- Availability and feasibility of prevention or self-protection by victims
- Need for federal law enforcement involvement
- Problems and obstacles confronting increased emphasis
- Benefits and costs resulting from increased federal emphasis
- Other important factors

Purposes of National Priorities

- Improved coordination and allocation of limited Federal investigative and prosecutorial resources on both the national and district level;

- Better coordination of Federal, state and local law enforcement efforts directed against white collar crime;

- More comprehensive and timely identification of trends or patterns in white collar crime requiring legislative initiatives or special emphasis in prevention, detection, investigation or prosecution;

- Expeditious development of new and more effective investigative techniques, prosecution practices, and training programs in white collar crime law enforcement;

- Furtherance of consistency and equal justice in Federal law enforcement, in conjunction with prosecutorial guidelines for United States Attorneys;

- Improved communication among law enforcement officials, Congress, the business community and members of the general public concerning white collar crime problems, their impact on society, and appropriate public and private measures for dealing with them.

Sources of Information

Two-hundred-forty (240) headquarters, regional and field offices of Federal investigative agencies and Department of Justice personnel, including the following:

Bureau of Alcohol, Tobacco and Firearms
Customs Service
Postal Inspection Service
Secret Service
Securities and Exchange Commission
Department of Agriculture
Department of Commerce
Department of Defense
Department of Energy
Department of Health, Education and Welfare
Department of Housing and Urban Development
Department of the Interior
Department of Labor
Department of Transportation
Environmental Protection Agency
General Services Administration
National Aeronautics and Space Administration
Small Business Administration
Veterans Administration

Department of Justice:
  Economic Crime Units/Special Fraud or Corruption Units
  Federal Bureau of Investigation
  Immigration and Naturalization Service
  Tax Division
  Land and Natural Resources Division

Agencies and Officials Primarily Involved in Implementing the Priorities

- United States Attorneys
- Economic Crime Units and Special Fraud or Corruption Units
- Criminal Division - Fraud, Public Integrity and General Litigation Sections
- Federal Bureau of Investigation
- Other Department of Justice Divisions - Tax Division, Antitrust Division, Land and Natural Resources Division
- Major Federal Investigative Agencies - Bureau of Alcohol, Tobacco and Firearms; Customs Service; Postal Inspection Service; Secret Service; Securities and Exchange Commission; Internal Revenue Service
- Inspectors General and their Equivalents in Federal Departments and Agencies

Department of Justice

EMBARGOED FOR RELEASE 2:00 P.M.
WEDNESDAY, SEPTEMBER 10, 1980

CRIMINAL
(202) 633-2017

Attorney General Benjamin R. Civiletti today announced national priorities for investigating and prosecuting white collar crime and released a report that identifies targeted crimes ranging from public corruption to frauds against consumers. The report is being distributed to all federal law enforcement agencies.

Mr. Civiletti said, "We intend to zero in on the kinds of white collar crime that most affect the people of this country. These crimes threaten the pocketbooks of the nation's citizens--as consumers, taxpapers, business persons and investors."

"Major white collar crime also threatens the integrity of our public and private institutions," Mr. Civiletti added. "Many of these crimes endanger health and safety and the quality of the environment for present and future generations."

The national priorities, which are effective immediately, will be implemented by all federal prosecutors and investigators. They are the result of an eight-month study of white collar crime conducted by the Department of Justice's Criminal Division.

The report was principally authored by Joseph B. Tompkins, Jr., Associate Director, Office of Policy and Management Analysis in the Criminal Division.

Mr. Civiletti pointed out that the setting of the priorities will assist federal, state, and local law enforcement.

He said, "The priorities will enable federal investigators and prosecutors in a number of agencies to work together more effectively in identifying major fraud and corruption cases.

(MORE)

The priorities will help pinpoint trends in white collar crime that may require legislative action or special emphasis by law enforcement agencies. And they will be helpful to local and state authorities because those officials will know specifically the kinds of crimes targeted for federal attention."

Mr. Civiletti announced the priorities at a news conference in Washington, D.C. Philip B. Heymann, Assistant Attorney General of the Department's Criminal Division; Charles B. Renfrew, Deputy Attorney General, William H. Webster, Director of the Federal Bureau of Investigation, and William P. Tyson, Acting Director, Executive Office for U.S. Attorneys, also attended.

The national priorities are divided in seven major categories:

-- Crimes against the government by public officials, including federal, state and local corruption;

-- Crimes against the government by private citizens, including tax fraud, procurement fraud, program-related fraud, counterfeiting, and customs violations;

-- Crimes against business, including embezzlement and bank fraud, insurance fraud, bankruptcy fraud, advance fee schemes, and labor racketeering;

-- Crimes against consumers, including defrauding of customers, antitrust violations, energy pricing violations and related illegalities;

-- Crimes against investors, including securities and commodities fraud and real estate swindles;

-- Crimes against employees, including life-endangering health and safety violations and corruption by union officials; and

(MORE)

- -- Crimes affecting the health and safety of the general public, including the illegal discharge of toxic, hazardous, or carcinogenic waste and life-endangering violations of health and safety regulations.

Mr. Civiletti pointed out that the national priorities will also aid law enforcement because they will:

- -- Expedite the development of new and more effective investigative techniques, prosecution practices, and training programs in white collar crime law enforcement;
- -- Further consistency and equal justice in federal law enforcement; and
- -- Improve communication among law enforcement officials, the Congress, the business community and members of the public generally, concerning white collar crime problems, their impact on society, and appropriate public and private measures for dealing with them.

Mr. Civiletti stated that federal law enforcement agencies have made considerable progress in combating white collar crime crime in the past few years.

"The Department's Economic Crime Enforcement Program, created in 1979, now has 18 units throughout the country. They play a significant role in gathering information about white collar crime, coordinating federal investigative and prosecutorial efforts, and developing new techniques for the prevention, detection, investigation, and prosecution of white collar crime," he said.

Also, the Attorney General said, the Criminal Division's Fraud, Public Integrity, and General Litigation sections have launched new initiatives against major fraud and corruption activities and against criminal regulatory offenses.

(MORE)

He noted that the FBI has increased its emphasis on white collar crime, with positive results in both the number and quality of cases. In August the FBI opened a "white collar crime hotline" in Washington to encourage people to provide information about graft, fraud, or corruption.

"Similarly, the Department's Antitrust Division, Tax Division, and Land and Natural Resources Division have intensified their efforts against white collar crime within their respective jurisdictions," Mr. Civiletti noted.

In addition to the Department, the major federal agencies that helped develop the national priorities include the Postal Inspection Service; Bureau of Alcohol, Tobacco, and Firearms; Customs Service; Secret Service; Securities and Exchange Commission; and the Offices of Inspector General in all major federal agencies.

Copies of the 50-page (plus appendices) report, "National Priorities for the Investigation and Prosecution of White Collar Crime," may be purchased from the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402. The price is $4.00 per copy, prepaid. The stock number is 027-000-00997-2.

# # # #

TAB B

Memorandum

Subject White Collar/Fraud Priorities for Eastern District of Virginia	Date October 31, 1980

To Honorable Charles B. Renfrew
Deputy Attorney General

From Justin W. Williams
United States Attorney
Eastern District of Virginia

The following is our list of priorities, and subsets therein, for our District:

1. Federal Procurement Fraud - noncorruption - $25,000 or more in aggregate losses
   a. Defense installations and production
   b. Overbilling of United States by contractors
   c. Contract cost mischarging (DOD, AID)
   d. Maintenance contracts
   e. Contract bid - fixing
2. Federal Corruption - Procurement
   a. Bribery, kickbacks, etc.
3. Victimization and misuse of governmental institutions
   a. Fraud perpetrated upon the judiciary
   b. Corruption of local attorney/prosecutor
   c. Corruption/bribery of federal officials/political figures
4. Crimes against investors
   a. Securities Act violations - misrepresentation to investors, sales of non-registered stocks
   b. Distributorships and franchises
   c. Ponzi schemes
5. Tax violations
6. Federal Program Fraud - $25,000 or more in aggregate loss
   a. Medicare/Medicaid fraud
   b. Misuse of SBA loans
   c. Grant and contract fraud/subcontractors fraud
7. Bribery to Union Officials - $5,000 or more in aggregate
   a. Payoffs to I.L.A. officials

It is worth mentioning that our District is somewhat unique in that we sit with almost equal permanent staffs in three cities each in areas with differing socio-economic bases. The federal presence in each area therefore is at once similar yet different so as to present opportunities for federal violations in the white collar/fraud area to run a spectrum perhaps wider in our District than in districts characterized by the presence of one or a few industries.

Over the years and continuing to date we have investigated and successfully prosecuted a number of cases in the area of federal contracting, especially military procurement. The enormous federal presence in Northern Virginia and in the Tidewater explains this - as might well be expected, fraud in government contracting is still the principal area of concern and challenge to us.

In Richmond, however, although the federal presence is not insubstantial, the pattern of white collar offenses more often than not involves banks, other commercial institutions, State and local governments, consumers, etc., directly as victims and not the federal government as is true in Alexandria and Norfolk.

Lastly, it is probably worth adding that because of the presence of Dulles International Airport and the fact that a substantial portion of the national federal establishment sits near Alexandria, we, like our colleagues in Washington, D. C., see a steady flow of unique, high visibility, and often non-reoccuring matters, many of which are often complex and tie up our senior trial counsel, who typically work in the fraud white collar area - the recent espionage case involving David Truong and Ronald Humphrey is but one example.

We hope the foregoing meets your needs. If there is any further information you require please call Mr. Joseph Fisher, Chief, Fraud and Corruption Division, 557-9100, on my staff.

TAB C

United States Department of Justice
ASSISTANT ATTORNEY GENERAL
CRIMINAL DIVISION
WASHINGTON, D.C. 20530

RECEIVED
DEC 15 12 59 PM '80
U.S. ATTORNEY'S OFFICE
ALEXANDRIA, VIRGINIA

DEC 12 '80

Honorable Justin W. Williams
United States Attorney
Eastern District of Virginia
117 South Washington Street
Alexandria, Virginia 22314

Re: Proposed District White
Collar Crime Priorities

Dear Mr. Williams:

Deputy Attorney General Renfrew has asked us to review your proposed district white collar crime priorities, submitted with your memorandum of October 31, 1980. Your proposed priorities demonstrate a great deal of thought and work by you and your colleagues. However, we have a few comments and suggestions concerning your proposed priorities which are intended to make your priorities consistent with and in furtherance of the Department's national effort in the white collar crime area and, at the same time, accommodate your local problems and concerns:

1. We have a general concern that you may have too many district priorities. Priority areas should be chosen with the expectation that, in a year or so from now, you will be able to point to some concrete accomplishments in each priority area, whether it be major cases opened and/or completed, innovative techniques used to detect or investigate illegal activity, or similar achievements. Of course, one can never predict with certainty the result of an investigative or prosecutive initiative; but we would rather pick a few spots where we are fairly confident of success, and avoid the disappointment of unduly raising expectations in too many areas. Depending on how you count them, your proposed priority list now includes between 12 and 17 items. You might want to consider consolidating some of them. For example, a number of your items relate to defense procurement fraud. You may want to regroup these into one or two priority areas. (Incidentally, if defense procurement fraud is going to be one of your district priority areas, in light of our common experience in that area we assume that you intend to target cases where the illegal acts are egregious and clear-cut and where criminal prosecution appears to be the most effective approach.) You may want to eliminate some items. Or, given the unique nature of your district, you may want to have three different sub-groups of district priorities, with each of the major cities having its own specific priorities. In any event, we suggest that you consider reducing somewhat the number of items on your priority list.

2. While most of your proposed priorities are very specific, we suggest that you make items #2 and #3.c. more specific, if at all possible. These items should be narrowed to a particular type of corruption or to a particular federal, state or local agency or program affected by corruption, if that is possible. Items #3.a. and #3.b., by contrast, are very specific; our concern with these items is that they may refer only to a specific case and not to a significant problem area involving more than one illegal incident. If they involve only one incident which is of a limited nature, then they may not deserve to be included on your list.

3. Most of your proposed priorities have appropriate dollar thresholds or other specifications. However, items #4 and #5 lack such specifications. We strongly suggest that you add some priority-defining criteria to both these items, whether it be dollar amounts involved, number of victims, or something else.

4. In communicating your priorities and their respective specifications to the law enforcement community, we suggest that you make it very clear, if you have not already, that the priority specifications are not intended to be and should not be interpreted as declination guidelines. The confusion between the two has arisen on a number of occasions, and we have gone to great lengths to make it abundantly clear to investigators and others that national and district priorities are in no way declination policies.

5. In asking you to be fairly specific in describing some of your priority areas, we are mindful that members of the public may seek access to your priority list by means of a Freedom of Information Act request. It would appear that exemption (b)(7) of the FOI Act might, in some of its provisions, apply to a district priority list and exempt at least portions of your list from disclosure. In relevant part, that exemption covers investigatory records compiled for law enforcement purposes to the extent that their release would interfere with on-going investigations or disclose the identity of a confidential source. (See 5 U.S.C. 552(b)(7)(A) and (D)). In addition, the same exemption protects the disclosure of information contained in investigative records compiled for law enforcement purposes to the extent that disclosure would constitute an unwarranted invasion of personal privacy. (See 5 U.S.C. (b)(7)(C)). Interference with an investigation, disclosing informants, and invading personal privacy are the main concerns that arise as the description of priority areas becomes more specific. The more general the description is, the more likely the exemptions will not apply; the more specific and detailed the descriptions are, then the more likely it will be that exemptions will apply. There are no hard and fast rules in this area and each item has to be weighed against the statutory exemptions on a case by case basis. The best example we can provide would be a district priority that specifies "federal corruption" affecting "X agency" or "Y program." In all probability we will have to disclose that "federal corruption" is one of your priorities. On the other hand, we can deny the name of the agency or program if the investigation is under way and is unpublicized, if the information came solely from a confidential source, or if, by naming an agency, it would indicate a sufficiently

small enough group that an invasion of personal privacy will occur. These are subjective judgments and can be challenged in litigation. Nevertheless we believe that anything that will truly interfere with your operations can be denied. If you have any specific questions about the FOIA and its potential application to your district priority list, I suggest that you call Fred Hess, Acting Director of the Criminal Division's Office of Legal Support Services (FTS/724-7030).

We assume that you or your colleagues have consulted with the federal investigative agencies in your district in formulating your proposed priorities, as well as with appropriate state and local law enforcement authorities. Such consultation is very important, if the priorities are to serve their intended purposes of: 1) providing focal points for the federal agencies' and your office's efforts in the white collar crime area; and 2) giving clear signals to state and local law enforcement authorities concerning which types of white collar crime are going to receive federal emphasis. In this regard, if we can be of any assistance by working with the headquarters personnel of any agency, please let me know.

I hope that these comments are helpful. They are intended to be constructive and to have beneficial results, both for your efforts and for our overall efforts in the white collar crime area. Please do not hesitate to call me or Jack Keeney if you have any questions concerning our comments. We would like to forward to Judge Renfrew for his final approval an agreed-upon list of priorities no later than December 31, 1980, so we would appreciate receiving your response to our comments as soon as possible. We will give your response expeditious treatment.

Thank you for your cooperation in this and other endeavors.

Sincerely,

Philip B. Heymann
Assistant Attorney General
Criminal Division

By John C Keeney
John C. Keeney
Deputy Assistant Attorney General
Criminal Division

TAB D

U.S. Department of Justice

Criminal Division

Office of the Deputy Assistant Attorney General

Washington, D.C. 20530

RECEIVED
JUN 23 12 30 PM '81
U.S. ATTY
ALEXANDRIA, VIRGINIA

JUNE 19, 1981

Honorable Justin W. Williams
United States Attorney
Eastern District of Virginia
701 Prince Street
Alexandria, Virginia 22314

Re: District White Collar Crime Priorities

Dear Mr. Williams:

As you probably know, D. Lowell Jensen took office not long ago as the Assistant Attorney General in charge of the Criminal Division. Mr. Jensen has asked me, in my capacity as chairman of the committee charged with implementing the national white collar crime priorities, to write and convey to you: (1) his support of and keen interest in the Department's efforts to combat white collar crime; and (2) his commitment to the full and expeditious implementation of the white collar crime priorities initiative, including the formulation and implementation of district white collar crime priorities.

With regard to the latter, our records indicate that on December 12, 1980, we sent you a letter containing our comments and suggestions concerning your proposed district priorities, which were submitted October 31, 1980. To date, we have received no response to our letter. We would appreciate being advised of the status of your district priorities, and we would ask that you submit revised priorities as soon as possible.

An important aspect of the Department's overall white collar crime program is the collection and analysis of detailed information on investigative and prosecutive activity. We will be collecting information from a number of sources, including the FBI, Inspector General offices and other investigative agencies. However, the source of information upon which we intend to rely most heavily is the United States Attorneys Docket and Reporting System. It is in your interest and our interest to make certain that your attorneys and your docket clerks do their utmost to make certain that the information entered into the Docket and Reporting System is complete, accurate and timely. We would appreciate your prompt and continuing attention to this matter.

If you have any questions concerning the priorities program or our overall efforts in the white collar crime area, please let me know. I look forward to receiving your revised priority list soon.

Sincerely,

John C Keeney

John C. Keeney
Deputy Assistant Attorney General
Criminal Division

TAB E

U.S. Department of Justice

United States Attorney
Eastern District of Virginia

JWW:ap

July 13, 1981

701 Prince Street
Alexandria, Virginia 22314

703/557-9100
FTS/577-9100

John C. Keeney
Deputy Assistant Attorney General
Criminal Division
Washington, D.C.

Re: District Wide White Collar Priorities
for the Eastern District of Virginia

Dear Jack:

Please forgive me for not responding earlier to your letter of June 19 in which you asked for refinement of the white collar crime priority list we submitted last fall. We have reviewed your letters of June 19 and December 12 with care, as well as the priority statement we submitted on October 31, 1980. Although the items on our list are numerous, nevertheless, they are germaine to cases that have either been recently litigated, or are under investigation in our three cities. Several of the items reflect one incident situations such as item seven, bribery to union officials, and thus as you suggest can be removed from our list. Reduction of items on our priority list is likewise mandated by the reduced number of attorneys we presently have assigned to our Fraud and Corruption Section. Through attrition the number of attorneys assigned to our white collar unit has shrunk from five to three. Accordingly our main district wide emphasis will be directed to categories one and six on our list, that is, federal procurement fraud and program fraud. The number of procurement fraud cases that we now have under investigation throughout the district should fully occupy our three attorneys throughout the next year.

Item three will be removed from the prioritiy list principally because it reflects single incident cases that for the most part have been successfully concluded.

We are also removing item four from our list. We are doing so principally because for almost a year now we have not had presented to our office any significant cases in this category. We are removing item five from our list. We are doing so because in most instances our office has somewhat limited input in the decision to proscute tax matters. Ultimately it is the tax division that plays the preeminent decision making role in this area.

Lastly we are removing item seven from our list. We do so since it relates to a single case, which was successfully prosecuted and thus concluded this spring in Norfolk.

We are leaving item two on our list. However, in spite of your suggestion, it is difficult to be anymore specific since often the corruption we encounter is the motivating force behind, and usually entwined with the myriad procurement and fraud schemes broken out in more detail in items one and six.

Thank you for taking the time in reviewing our priority list. Your comments were very helpful to us in refocusing and reassessing our white collar priorities within the context of our available and limited resources. If I can be of any further help to you please give me a ring.

Very truly yours,

Justin W. Williams
United States Attorney

Enclosure

TAB F

Memorandum

Subject White Collar/Fraud Priorities for
Eastern District of Virginia

Date October 31, 1980

To Honorable Charles B. Renfrew
Deputy Attorney General

From Justin W. Williams
United States Attorney
Eastern District of Virginia

The following is our list of priorities, and subsets therein, for our District:

1. Federal Procurement Fraud - noncorruption - $25,000 or more in aggregate losses
    a. Defense installations and production
    b. Overbilling of United States by contractors
    c. Contract cost mischarging (DOD, AID)
    d. Maintenance contracts
    e. Contract bid - fixing
2. Federal Corruption - Procurement
    a. Bribery, kickbacks, etc.
3. Victimization and misuse of governmental institutions
    a. Fraud perpetrated upon the judiciary
    b. Corruption of local attorney/prosecutor
    c. Corruption/bribery of federal officials/political figures
4. Crimes against investors
    a. Securities Act violations - misrepresentation to investors, sales of non-registered stocks
    b. Distributorships and franchises
    c. Ponzi schemes
5. Tax violations
6. Federal Program Fraud - $25,000 or more in aggregate loss
    a. Medicare/Medicaid fraud
    b. Misuse of SBA loans
    c. Grant and contract fraud/subcontractors fraud
7. Bribery to Union Officials - $5,000 or more in aggregate
    a. Payoffs to I.L.A. officials

It is worth mentioning that our District is somewhat unique in that we sit with almost equal permanent staffs in three cities each in areas with differing socio-economic bases. The federal presence in each area therefore is at once similar yet different so as to present opportunities for federal violations in the white collar/fraud area to run a spectrum perhaps wider in our District than in districts characterized by the presence of one or a few industries.

Over the years and continuing to date we have investigated and successfully prosecuted a number of cases in the area of federal contracting, especially military procurement. The enormous federal presence in Northern Virginia and in the Tidewater explains this - as might well be expected, fraud in government contracting is still the principal area of concern and challenge to us.

In Richmond, however, although the federal presence is not insubstantial, the pattern of white collar offenses more often than not involves banks, other commercial institutions, State and local governments, consumers, etc., directly as victims and not the federal government as is true in Alexandria and Norfolk.

Lastly, it is probably worth adding that because of the presence of Dulles International Airport and the fact that a substantial portion of the national federal establishment sits near Alexandria, we, like our colleagues in Washington, D. C., see a steady flow of unique, high visibility, and often non-reoccuring matters, many of which are often complex and tie up our senior trial counsel, who typically work in the fraud white collar area - the recent espionage case involving David Truong and Ronald Humphrey is but one example.

We hope the foregoing meets your needs. If there is any further information you require please call Mr. Joseph Fisher, Chief, Fraud and Corruption Division, 557-9100, on my staff.

Memorandum

AUG 27

U.S.

Subject

District White Collar Crime Priorities

Date

AUG 21 1981

To Honorable Justin W. Williams
United States Attorney
Eastern District of Virginia

From Rudolph W. Giuliani
Associate Attorney General

In accordance with Paragraph 6a. of Attorney General Order No. 817-79, as amended, I hereby approve the attached list of priorities for the investigation and prosecution of white collar crime in your district. It is my understanding that these district priorities are the result of discussions between your office and appropriate officials in the Criminal Division and that they have the Criminal Division's concurrence.

The formulation of these district priorities obviously required a great deal of time and attention by you, your colleagues and the investigative agencies in your district. I think it was time well-spent. I am confident that, properly employed, these priorities can serve the purposes for which they were intended: 1) providing focal points for your office and the relevant federal investigative agencies in designing and carrying out aggressive law enforcement initiatives in the white collar crime area; 2) assisting in the allocation and management of scarce investigative and prosecutive resources in your district; and 3) providing clear signals to state and local law enforcement authorities concerning which types of white collar crime are going to receive federal emphasis. They should also help you and the Department describe and assess the results of our combined efforts to combat white collar crime.

Your district priorities should be periodically reevaluated, as the national priorities will be. You should inform this office and the Criminal Division of any proposed changes in your priority designations. Similarly, we will inform you of any contemplated revisions of the national white collar crime priorities and we will seek your assistance in that regard.

Thank you again for your work in formulating district priorities. We look forward to their successful implementation.

DISTRICT WHITE COLLAR CRIME PRIORITIES

Federal District: Eastern District of Virginia

United States Attorney: Justin W. Williams
Chief, Fraud and Corruption Division: Joseph Fisher

Priorities (no ranking implied)

1. Federal Procurement Fraud - noncorruption - $25,000 or more in aggregate losses.

    a) Defense installations and production
    b) Overbilling of United States by contractors
    c) Contract cost mischarging (DOD, AID)
    d) Maintenance contracts
    e) Contract bid-fixing

2. Federal Corruption - Procurement.

    a) Bribery, kickbacks, etc.

3. Federal Program Fraud - $25,000 or more in aggregate losses.

    a) Medicare/Medicaid fraud
    b) Misuse of SBA loans
    c) Grant and contract frauds/subcontractors fraud

CONCURRENCE:

D. LOWELL JENSEN
Assistant Attorney General
Criminal Division

Dated: 8-20-81

APPROVAL:

Rudolph W. Giuliani
RUDOLPH W. GIULIANI
Associate Attorney General

Dated: 8-21-81

EXHIBIT U

NOVEMBER 1981 -- FISHER-ARONICA STATUS REPORT

STATUS REPORT RE: INVESTIGATION OF NEWPORT NEWS SHIPBUILDING CLAIMS FOR EQUITABLE ADJUSTMENT

JOSEPH A. FISHER, III
Assistant United States Attorney
Chief, Fraud Section
Eastern District of Virginia

JOSEPH J. ARONICA
Assistant United States Attorney
Eastern District of Virginia

DAVID B. SMITH
Attorney, Appellate Section
Criminal Division
Department of Justice

CAUTION: [redacted]

STATUS REPORT RE: INVESTIGATION OF NEWPORT NEWS SHIPBUILDING CLAIMS FOR EQUITABLE ADJUSTMENT

TABLE OF CONTENTS

Page

I. INTRODUCTION 1

II. EVIDENCE OF A MASSIVE CONSPIRACY TO DEFRAUD THE UNITED STATES 6

- 1. The Organization of the Yard's Claims Effort . . . 6
- [redacted] 8

III. INTRODUCTION TO THE CRUISER CONTRACT AND THE CLAIMS PROCESS 11

- 1. The Cruiser Contract 11
- 2. The Claims Process 16
  - A. Introduction 16
  - B. Change Orders 16
  - C. Authority to Issue Change Orders 17
  - D. Written, Oral and Other Orders 18
  - E. Scope of Change Orders 18
  - F. Notice 19
  - G. Equitable Adjustment 19
  - H. The Disputes Procedure 20

IV. CLAIM NO. 5.2.8 ON THE REACTOR COMPARTMENT VENTILATION CONTROL AIR SYSTEM 23

Introduction 23

- 1. A Physical Description of the Ventilation Control Air System 24
- 2. NNS' Theory of Entitlement on the Ventilation Control Air System 26

3. A Detailed Analysis of the Ventilation Control Air System Claim Based upon the Contract Documents 32

4. An Analysis of the Several Preliminary Draft Narratives of the VCAS Claim 46

   A. Exhibit 1 47

   B. Exhibit 3 48

   C. Exhibit #2A 49

   D. Exhibit #2B 49

   E. Exhibit #7 50

   F. Exhibit #8 51

   G. Exhibit #4 52

   H. Exhibit #6 52

   I. Exhibit #5 53

5. [redacted] 55

V. OTHER FALSE CLAIM ITEMS UNDER INVESTIGATION 69

1. OSHA and EPA Claims. 69

2. Navy Recruiting Claims 73

3. Claim Item VII.B.8 (Bow Dome) and Claim Item VIII.B.9 (Cathodic Protection) in NNS' Proposal for Equitable Adjustment on the 688 Class Submarine. 77

4. Discharge Sea Chests Claim 79

5. Added Interest or Financing Costs. 85

6. Reactor Shielding Claim. 87

VI. THE PROPOSALS FOR EQUITABLE ADJUSTMENT ARE "CLAIMS" WITHIN THE MEANING OF 18 U.S.C. §287 AND THE STATUTE OF LIMITATIONS DOES NOT BAR AN INDICTMENT BASED ON THE FILING OF THOSE CLAIMS. 95

VII. CONCLUSION AND RECOMMENDATIONS 107

STATUS REPORT RE: INVESTIGATION OF NEWPORT NEWS SHIPBUILDING CLAIMS FOR EQUITABLE ADJUSTMENT

I. INTRODUCTION

In January 1981, Justin W. Williams, the United States Attorney for the Eastern District of Virginia, after consultation with members of his senior staff, Joanne Harris, Chief of the Fraud Section, Department of Justice, and with the approval of the then Acting Assistant Attorney General, Jack Keeney, directed that an investigation into allegations of fraud in the submission of cost overrun claims by Newport News Shipbuilding & Dry Dock Co. (hereinafter "NNS" or "the Yard") be continued. 1/ The United States Attorney's decision was made after a very detailed analysis of a preliminary prosecution report had been undertaken.

The preliminary report's conclusion that there was insufficient evidence of criminal wrongdoing by the Yard in the preparation and filing of its claims and the report's recommendation to terminate the investigation were rejected by the United States Attorney as premature, absent the kind of thorough investigation

---

1/ The cost overrun claims are contained in separate "proposals for equitable adjustment" on four ship construction contracts. The claims were referred by the Navy to DOJ for investigation. NNS' proposals for equitable adjustment related to contracts numbered N00024-67-C-0325 (2 aircraft carriers), N00024-69-C-0307 (2 637 Class attack submarines), N00024-71-C-0270 (4 688 Class attack submarines) and N00024-70-C-0252 (3 guided missile cruisers). Each proposal for equitable adjustment contains many separate claims of entitlement. Generally, each claim is separately analyzed and priced out. NNS' claims effort was prodigious. Some 1500 NNS employees were involved in the preparation of the claims. The claim books, stacked together, are thicker than the Encyclopedia Britannica and much more technical.

warranted by the seriousness of the Navy's allegations. The prosecution report was prepared principally by Eliot Norman, former Assistant United States Attorney for the Eastern District of Virginia, who led the investigative team comprised, at various times, of attorneys from the Fraud Section of the Department of Justice, attorneys from the Navy assigned to the Department of Justice, and numerous FBI and NIS agents. This initial prosecution report purported to represent the collective view of all the attorneys then assigned to the investigation. 2/ In fact, it was later discovered that the Navy attorneys disagreed with Mr. Norman's recommendation.

Of the many claims addressed in the preliminary prosecution report, we determined that NNS' claim on the Control Air System (contained in the Proposal for Equitable Adjustment on the cruiser contract) should be focused upon. It was the only claim item for which the preliminary claim drafts had not been destroyed by NNS, as part of its document destruction policy. The preliminary drafts contradicted the facts stated in the final claim version submitted to the Navy. 3/ [redacted]

2/ Copies of this preliminary prosecution report as well as spade memos prepared by attorneys in the Fraud Section of the United States Attorney's Office, Eastern District of Virginia, have been submitted to Ms. Harris at the Department of Justice.

3/ The preliminary drafts revealed a careful massaging of fact and legal theory by claims writers to create a final version that could be expected to pass muster with the Navy. An analysis of these crucially important preliminary drafts is contained in Part IV, Section 4 of this memorandum.

[redacted] Finally, this claim appeared typical of a pattern of fraud involving other claims referred to the Department of Justice, most of which had not been investigated in depth and some of which apparently had not been investigated at all. 4/ Many claim narratives omitted critical facts and/or contained false statements of material facts justifying entitlement. Other claim narratives, although not containing false facts, appeared to be predicated upon legal theories of entitlement with little or no support in the body of government contract law; while other claims contained false statements as well as spurious theories of entitlement.

[redacted]

4/ [redacted]

Part II lays out the evidence of a massive conspiracy to inflate the value of NNS' claims against the Navy. Part III provides an introduction to the cruiser contract and the cost overrun claims process. As indicated above, Part IV focuses entirely on a single claim item within the Proposal for Equitable Adjustment on the cruiser contract -- the Ventilation Control Air System claim. Part V briefly summarizes the evidence on several other claim items -- most of which also arise out of the DLGN 38-40 cruiser contract -- [redacted] These summaries are sufficient to show that each of the claim items discussed is false. The reader who does not want to wade through our very detailed technical analysis of the Ventilation Control Air System might wish to skip Section 3 of Part IV, which analyzes the contract documents relating to that claim and demonstrates that the claim is false on that basis.

Part VI analyzes two legal questions raised by Newport News in the "Confidential Memorandum" it recently submitted to the Department of Justice. We show that the proposals for

---

5/ The present team's investigation has thus far focused almost entirely on the DLGN 38-40 cruiser contract claims for practical reasons that have nothing to do with the relative merits of NNS' cost overrun claims on the various ship contracts. Thus, we have no reason to believe that the claims on the aircraft carriers and submarines have more integrity than the cruiser claims.

equitable adjustment submitted by NNS are "claims" within the meaning of 18 U.S.C. §287. 6/ We then show that a prosecution of NNS is not barred by the statute of limitations and that an important later part of the conspiracy relates to efforts by NNS to pressure the Navy into agreeing to a favorable settlement of its cost overrun claims. Part VII contains our brief conclusion and recommendations.

6/ The proper unit of prosecution is a difficult question we have not yet researched. It may be that each proposal for equitable adjustment constitutes a single claim for purposes of prosecution. Alternately, each separately priced claim item within the proposals may provide the basis for a separate Section 287 count. See generally, United States v. Bornstein, 423 U. S. 303 (1976).

II. EVIDENCE OF A MASSIVE CONSPIRACY TO DEFRAUD THE UNITED STATES

1. The Organization of the Yard's Claims Effort

Due to the unprecedented size of its claims effort, NNS created a special organizational component known as 'Contract Controls' to investigate, analyze, write and price out the multitude of individual claim items. [redacted]

[redacted] Contract Controls, divided into three separate parts [redacted]. One person was in charge of submarine construction and overhaul, another all surface ship construction and overhaul, and a third in charge of support, administration and clerical services [redacted]. The next rung on the organizational ladder consisted of 'team leaders' -- individuals with supervisory responsibility for preparing the claims on various classes of ships. Below the 'team leaders' were 'analysts' and 'investigators.' Analysts were assigned specific claim items to research and write up. More often than not, they would be engineers, designers, production control schedulers and other technical types on loan from their respective departments to Contract Controls. They frequently had first-hand involvement in the design and/or production of the system assigned to them for claims activity [redacted]

The pricing function in claims preparation was divorced from the claims writers' area of responsibility. The suggestion made in the earlier prosecution report was that this division of labor was an index of the Yard's "institutional good faith" in its claims effort. Because there was no hard evidence of prearranged dollar target figures being imposed on the claims writers, for which they were required to create a theory of Navy liability, the Yard's integrity was presumed.

We believe this conclusion was erroneous for a number o reasons. First, the pricing of claims, like the pricing of bids on new ship construction, is an engineering specialty that most, if not all, of the claims writers were incapable of performing. Second, this division of functions enabled the senior claims writers to use their in-house cost estimators as good technical sounding boards for their claim theories, i.e., it afforded Contract Controls the benefit of obtaining 'dry runs' prior to submitting its creative endeavors to the Navy. Third, a division of labor would necessarily limit and fragment knowledge and appear to negate corporate criminal intent. Challenged claim items could more plausibly be explained as "mistakes". Thus, a sinister inference could be drawn as readily as an innocent one from the structure NNS set up for its claims effort. With the exception of a few top people, no one would be in a position to put the whole picture of the claims effort together.

III. INTRODUCTION TO THE CRUISER CONTRACT AND THE CLAIMS PROCESS

1. The Cruiser Contract

The Request for Proposal (RFP) on the 3 cruisers (DLGN 38, 39, 40) was issued to the Yard in November 1969. The RFP contained, as is customary, detailed specifications and guidance drawings so as to enable the contractor to prepare its bid. The contract for these three nuclear powered cruisers, identified by number N00024-70-0252, was definitized effective December 21, 1971 when modification P00007 was signed, establishing a delivery date, target price, target profit, incentive fee share arrangement, ceiling price and other provisions. The arrangement by which NNS was to be compensated is described in Defense Acquisition Regulation (DAR) §3-404.4 as a fixed-price incentive contract. (DAR §3-404.4 is set forth in the separate appendix to this memorandum as Exhibit #10).

Understanding this type of contract will allow the reader to appreciate precisely what NNS was seeking in its claims effort. Under a fixed-price incentive contract, the contractor is rewarded if he performs under projected costs and is penalized if he performs over projected costs. A good discussion of the fixed-price incentive contract is contained in Department of the Army Pamphlet No. 27-153, PROCUREMENT LAW, at 5-5 (January 1956 ed.):

(1) Fixed-price incentive contract. The fixed-price incentive contract is a fixed-price contract providing for a variable profit to the contractor. The amount of profit is determined by a formula set forth in the contract which rewards the contractor with additional profit when he operates efficiently and penalizes him by reducing his profit when he operates inefficiently. Use of this contract requires, first, that a realistic cost estimate (called the target cost) be made. To this amount a reasonable allowance for profit (called target profit) is added. A maximum amount which the final contract price cannot exceed (called ceiling price) is next determined. A final profit and adjustment formula is then established which should reflect the risks involved. After performance of the contract, the final costs are determined by negotiation between the contractor and the Government. The formula is then applied to the final costs to determine the final profit. When the actual cost of the contract equals the target cost, then the final profit equals the target profit. If the final cost of the contract is less than the estimated cost the contractor shares the cost savings by receiving a profit greater than the target profit. A final cost greater than the target cost causes the contractor to share in the cost overrun by receiving a profit less than the target profit. If the final cost equals the price ceiling, the contractor receives no profit; and when the final cost exceeds the price ceiling, the contractor must absorb the excess at his own expense. In this type of contract, the contractor is required to peform even if his costs rise considerably above the price ceiling.

The foregoing can be illustrated with the following three examples. Situation one (1) assumes an underrun of anticipated cost; situation two (2) assumes an overrun of anticipated cost; situation three (3) assumes a cost overrun beyond ceiling price. For all three examples the following figures are assumed:

Target Cost (TC)	-	$100,000
Target Fee (TF)	-	$ 10,000
Ceiling Price (CP)	-	$120,000
Share Ratio (SR)	-	60/40 *

* The government's share appears on the left side of the ratio.

Situation (1): Assume the contractor performs for $90,000; he gets $90,000, i.e., his costs, plus his fee of $10,000; in addition he will share 40% of the $10,000 cost underrun or $4,000. Thus the contractor will receive a total of $104,000. The contractor's total profit is $14,000 rather than the $10,000 he would have received had he performed at projected or target cost. In this example, the contractor has been rewarded for his efficiency in performing below target cost.

Situation (2): Assume the contractor performs for $110,000; he will receive from the government the full amount of his incurred costs of $110,000; however, he will receive a total of only $116,000. His profit is $6,000, $4,000 less than the target fee of $10,000. The math on this is as follows: $10,000 cost overrun X 40% = $4,000; $10,000 (TF) - $4,000 = $6,000 profit; $110,000 (costs) + $6,000(profit) = $116,000. Here the contractor is penalized for his inefficiency in performing over target cost.

Situation (3): Assume the contractor performs for $125,000; he will receive only $120,000 from the government. In this situation the contractor finds himself in a loss position. However, the government has no obligation beyond the ceiling price.

Another term associated with the fixed-price incentive contract is Point of Total Assumption (P.T.A.). This is reached when the cost plus computed profit reaches ceiling; thus, if cost should increase further the government will pay no more. Even when P.T.A. is reached, the contractor still makes a profit until ceiling price (CP) is reached, but the contractor will absorb 100% of all costs beyond the P.T.A. After CP is reached, the contractor is in a loss situation.

All the foregoing terms and concepts are graphically illustrated in Exhibit #12 in the appendix.

PTAs?

As the earlier prosecution report indicated, NNS had overrun the contract target costs by approximately $200 million. If the government was held responsible for these overrun costs, NNS would be entitled to an equitable adjustment to the various target figures. The object of the claims effort was to push the T.C.'s and ceiling prices (and hence P.T.A. figures) as far to the right on the graph as possible. The Yard's plan was to inflate the actual amount of its cost overruns by a huge factor with the expectation of settling with the Navy at a percentage of the total amount claimed - hopefully at a figure that would put the Yard in a profit position.

The claims were so massive that they had to be disposed of outside normal Navy channels. The Navy established a special Claims Settlement Board chaired by Admiral F.F. Manganaro. It settled NNS' claims on contracts covering seven submarines, two aircraft carriers and three cruisers (DLGN 38, 39, 40) for approximately $163.7 million on October 5, 1978. Earlier, in February 1977, the Navy had settled NNS's claim on two predecessor nuclear cruisers (DLGN 36 and 37) for $44.4 million. In sum, NNS's claims effort netted approximately $208 million -- a figure placing the Yard in a profit position on its Navy contracts. Coincidentally or not, this $208 million figure represented approximately a fifth of the almost $1 billion ceiling price adjustment claimed by NNS in its several proposals for equitable adjustment.

2. The Claims Process

A. Introduction

Here, we briefly discuss the claims process to enable the reader to understand the contractual basis for entitlement to reimbursement for additional expenditures caused by the government when it modifies the basic contract by altering such things as specifications, delivery date, price and quantity. The reader should also understand the procedural route, defined by the contract and the DAR provisions, which the contractor must follow in order to obtain such additional compensation.

B. Change Orders

Pursuant to the changes clause in the cruiser contract, the Navy reserved the right to unilaterally modify its terms 9/ DAR §1-201.1 defines a change order as "a written order signed by the contracting officer, directing the contractor to make changes which the changes clause of the contract authorizes the contracting officer to order without the consent of the contractor." According to the changes clause in the cruiser contract, this right was to be exercised by written direction from the contracting officer and was limited to "changes within the general scope of this contract." The clause allows the contracting officer to make modifications only in any one or more of the following:

9/ The changes clause is found in Article 29 of the DLGN 38-40 contract. It is set forth on pages 9-11 of the CITAR (Ex. #14) in the appendix.

(i) drawings, designs or specifications;
(ii) methods of shipment or packaging;
(iii) place of delivery.

This right of the Navy to make the changes specified in the changes clause was provided for at the time the contract was executed. Thus, neither the consent of the contractor nor new consideration is necessary in order for the change order effectively to modify the terms of the contract. The Navy's exercise of its right to issue a change order usually entitles the contractor to an equitable adjustment; however, agreement on appropriate equitable adjustment is not a condition precedent to the effectiveness of a change order. Army Pamphlet No. 27-153, PROCUREMENT LAW, at 10-4 (1976).

C. Authority to Issue Change Orders

As the changes clause indicates, it is the contracting officer, as the authorized agent of the government, who may make changes at any time within the scope authorized by the clause. DAR §1-201.3 provides that the term contracting officer "also includes the authorized representative of the contracting officer acting within the limits of his authority."

D. Written, Oral and Other Orders

Paragraph (a) of the changes clause of the cruiser contract requires that change orders be in writing. Paragraph (b) addresses communications other than formal written directives which the contractor might consider a change order. It provides, in pertinent part:

> (b) If the Contractor considers that any other written or oral communication, including any order, direction, instruction, interpretation, or determination, received from a representative of the Government, or that any other action or omission of the Government, constitutes a change order, the Contractor shall so advise the Contracting Officer in writing within ten (10) days, and shall request his written confirmation thereof.

This provision in the changes clause is a recognition of the *de facto* or "constructive" change order. We shall discuss the constructive change order in more detail below.

E. Scope of Change Orders

As discussed above, paragraph (a) of the changes clause limits changes to those "within the general scope of this contract." If a court or administrative review board finds that a modification is outside the general scope of the contract, then it is deemed a "cardinal" change as contrasted to a "permissible" change. If the change is not within the scope of the work contemplated by the parties, then it is one which the contractor can legally refuse to perform. Prior to the enactment of the Contract Disputes

Act of 1978, 41 U.S.C. §605, a cardinal change allowed the contractor to sue for breach of contract damages in the Court of Claims and thus divested the administrative review boards of jurisdiction. Army Pamphlet No. 27-153 at 10-7. 10/

F. Notice

Paragraph (e) of the changes clause of the cruiser contract requires the contractor to submit a claim for equitable adjustment occasioned by a change order to the contracting officer within 30 days from the date of receipt by the contractor of the notification of the change.

G. Equitable Adjustment

The term "equitable adjustment" is used to describe administrative means of arriving at a price adjustment once a contract has been modified by a change order. It can result in either an increase or decrease in the price. The Court of Claims explains equitable adjustments as follows:

> equitable adjustments ... are simply corrective measures utilized to keep a contractor whole when the Government modifies a contract. Since the purpose underlying such adjustments is to safeguard

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10/ Section 8d of the Contract Disputes Act of 1978, 41 U.S.C. §607, has expanded the jurisdiction of agency boards of contract appeals. These boards now have the power to decide all claims relating to a contract and may grant any relief to which the contractor would be entitled if asserting a claim in the Court of Claims. Accordingly, breach of contract claims may be settled by the boards.

> the contractor against increased costs engendered by the modification, it appears patent that the measure of damages cannot be the value received by the Government, but must be more closely related and contingent upon the altered position in which the contractor finds himself by reason of the modification.11/

H. The Disputes Procedure

Effective March 1, 1979, the Contract Disputes Act of 1978 significantly altered existing disputes procedures. The new provisions apply not only to contracts awarded after the effective date but also to any claim on a contract notwithstanding the award date, if the contractor elects to proceed under the new rules.12/ Since the Yard's claims for equitable adjustment were filed prior to the effective date of the Act, and since the Yard did not elect to proceed under the Act, attention will be focused upon the former procedure.

A dispute begins when a disagreement arises between the contractor and the contracting officer. The preferred method of settling disputes is of course by agreement between the

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11/ Bruce Constr. Corp. v. United States, 163 Ct. Cl. 97, 100, 324 F.2d 516, 518 (1963).

12/ Contract Disputes Act of 1978, 41 U.S.C. §605.

parties. Failing that, the first step in the disputes procedure prescribed by the disputes clause of the contract is for the contracting officer to decide the dispute unilaterally. See Army Pamphlet No. 27-153 at 13-3. This process is triggered when the contractor files his claim for equitable adjustment pursuant to the changes clause. Paragraph (e) of the changes clause of the cruiser contract provides, in pertinent part:

> (e) Any claim by the Contractor for adjustment under this clause must be asserted within 30 days from the date of receipt by the Contractor of a written change notice under (a) above or the furnishing of a written notice under (b) above; provided, however, that the Contracting Officer if he decides the facts justify such action, may receive and act upon any claim asserted at any time prior to final payment under this contract.

Paragraph (f) provides that "[f]ailure to agree to any adjustment shall be a dispute concerning a question of fact within [the disputes clause]." The disputes clause requires the contracting officer to reduce his decision to writing and to advise the contractor of his right to appeal his decision to the Armed Services Board of Contract Appeals (ASBCA).13/

13/ See DAR §1-314(d).

Thus, under this system, factual disputes unable to be worked out at the contracting officer level were to be settled by the ASBCA, the duly authorized representative of the Secretary of Defense. The decision of the Board as to questions of fact was to be "final and conclusive unless determined by a court of competent jurisdiction to have been fraudulent, or capricious, or arbitrary, or so grossly erroneous as necessarily to imply bad faith, or not supported by substantial evidence."[14]

Thus, the claims that are the subject of this investigation are those written demands for payment on cost overruns that NNS submitted to the contracting officer for his unilateral evaluation.

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[14] DAR §7-103.12(a), para.(a).

IV. CLAIM NO. 5.2.8 ON THE REACTOR COMPARTMENT VENTILATION CONTROL AIR SYSTEM

Introduction

NNS' Proposal for Equitable Adjustment on the cruisers was filed with the Navy on August 8, 1975. Claim Item 5.2.8 for the Ventilation Control Air System was but one of approximately 60 separately priced out claims in the Proposal for Equitable Adjustment filed on the cruisers. On August 1, 1977, NNS filed with the contracting officer a letter updating its costs on several of its proposals for equitable adjustment, including that for the cruisers. A copy of that letter is included in the appendix and identified as Exhibit #15.

In this part of our memo, we review the evidence relating to Claim Item 5.2.8 in great detail. We do this for two reasons. First, this claim is important because it alone reveals the Yard's modus operandi in preparing its fraudulent cost overrun claims. Second, this is the one claim item that has been thoroughly investigated by the current prosecution team [redacted] We have divided this part of the memo into five sections. In Section 1, we describe the physical characteristics of the Ventilation Control Air System (VCAS). In Section 2, we describe the Yard's claim for its cost overrun on the VCAS and briefly explain why the claim is false. In Section 3, we show in more detail that Claim Item 5.2.8 is false, based on the contract documents themselves.

In Section 4, we analyze the preliminary drafts of Claim Item 5.2.8 to show the fraudulent modus operandi used by NNS to develop the claim item. Finally, in Section 5, we review the highlights of the 1700 pages of grand jury testimony taken on this single claim item. The falsity of Claim Item 5.2.8 is demonstrated by the contract documents, the preliminary drafts of the claim [redacted] Together, they constitute overwhelming evidence of criminal fraud by Newport News. Moreover [redacted] we have been able to neutralize all witnesses who could possibly be put forward by the Yard in an attempt to escape conviction on this claim item.

1. A Physical Description of the Ventilation Control Air System

The Navy's Claim Item Technical Analysis Report (hereafter CITAR)15/ defines the reactor compartment Ventilation Control Air System (VCAS) as follows:

> The reactor compartment ventilation control air system is a system of pipes and valves that controls the flow of compressed air from the ship's compressed air system to the individual pneumatic operators on the large butterfly valves in the reactor compartment ventilation system.

[redacted]

15/ Navy experts prepared CITARS on each of the multitude of claim items. Needless to say, the time, effort and money spent in their preparation was prodigious. Without exception, the CITAR's we have reviewed represent meticulous research and analysis, and provide a sound basis upon which to commence investigation. The CITAR on the Control Air System is included in the appendix as Ex. #14.

The reactor compartment Ventilation Control Air System is a system separate from the reactor compartment ventilation system. The VCAS is the activator of the reactor compartment ventilation system. [redacted]

NNS separately priced out and claimed overruns on both the reactor compartment Ventilation Control Air System and the reactor compartment ventilation system (hereafter "ventilation system").

The ventilation system basically functioned to cool the nuclear reactor plant on the ship by bringing cool air from the outside in with fans, and then exhausting the heat through the stacks.

The ventilation system on the DLGN 38-40 series of cruisers was considerably bigger and more complex than its predecessor system on the immediately preceding class of cruisers, the DLGN 36-37, which NNS also built.

Some of the largest components comprising the ventilation system on both the DLGN 36 and 38 ships were valves. To simplify, there were five valves on the DLGN 36 cruisers for each reactor plant, and all of them were "diverting valves";

16/ Neither of these two systems are to be confused with the "reactor plant control air system." As the Navy's experts note in footnote 1 on page 8 of the CITAR: "The reader's attention is called to the fact that the reactor plant control air system in both CGN-36 and CGN-38 is not the reactor compartment ventilation control air system." The reactor plant control air system controls reactor plant components other than the ventilation valves and is a separate system.

> for bid purposes that he would be building a simpler reactor compartment ventilation control air system similar to that in CGN 36 except for the high pressure portion of the system which he states he properly recognized as being more complex in CGN 38 than in CGN 36. He asserts that, subsequent to the contract definitization, continued Government actions and inactions precluded his recognition of the effort he would have to expend and added to this effort.

Ex. #14 at p. 2. This factual predicate of defective specifications and a vague guidance drawing, advanced as a basis for entitlement, is described in the lexicon of Government contract law as a "constructive change order." [redacted]

The authors of Army pamphlet 27-153 describe the constructive change order as a legal fiction and define it as:

> any conduct by a contracting officer or his authorized agent, other than a formal change order or supplemental agreement, which has the effect of prescribing new or different work than required under the contract. In effect, the Boards exercise a corrective function over contracting officers by retroactively recognizing Government caused changes to a contract, and by providing relief as prescribed in the "changes clause".

Id. at p. 10-6.

The evidence [redacted] shows that what in fact happened was that the Yard "blew the bid." The Ventilation Control Air System on the DLGN 38 series of cruisers was a brand new system designed to service the upgraded reactor plant ventilation system. Because the VCAS was so integrally related to the reactor compartment ventilation system (a major nuclear system), the Navy in its specifications (supplied to the Yard as part of the bid package with the RFP) explicitly defined the VCAS itself as a "nuclear system", and mandated that it be built according to non-deviation working drawings that would be furnished by the Navy to the Yard.

The investigation [redacted] revealed that when assignments were made to the Yard's new ship cost estimators (whose job it was to prepare the contract bid figures) the VCAS item simply fell through the cracks. The non-nuclear section apparently thought the nuclear section had cognizance over the item and vice versa. [redacted]

[redacted]

substantial part without charge for that specific item. The Yard will argue that the equities are therefore against an indictment based upon the VCAS claim. We strongly disagree, for a number of reasons.

In the first place, the VCAS claim is but one of many false claims knowingly submitted by NNS. It is not an isolated instance of the Yard seeking, albeit through devious means, to make itself whole for work it has performed.17/ Second, the price for the DLGN 38-40 contract was negotiated on a gross or "bottom line" basis, not item by item. It is a fact that defense contractors sometimes submit low bids with the expectation of making a killing on subsequent change orders and claims activity. Third, the Yard had an avenue of relief available to it had it simply wished to seek compensation for its error with regard to the VCAS item bid. Public Law 85-804, 50 U.S.C. (Supp.) 1431-1436 affords a contractor relief in certain situations where he suffers a loss because of unfair government action. Pursuant to DAR Section 17-204.3(ii), relief is available for "a mistake on the part of the contractor which is so obvious that it was or should have been apparent to the contracting officer."

Rather than pursuing what would have been a colorable claim under DAR Section 17-204.3(ii), or seeking relief through a private bill in Congress (see Procurement Law at p. 13-14), the Yard chose to file a totally false claim on the Control Air item.

The seriousness with which the Congress regards the filing of false claims is underscored by the Contract Disputes Act of 1978, 41 U.S.C. §604, which provides:

> If the contractor is unable to support any part of his claim and it is determined that such inability is attributable to misrepresentation of fact or fraud on the part of the contractor, he shall be liable to the government for an amount equal to such unsupported part of the claim in addition to all costs to the Government attributable to the cost of reviewing said part of his claim. Liability under this subsection shall be determined within six years of the commission of such misrepresentation of fact or fraud.

Under this provision there need be no actual damage to the government other than the costs attributable to reviewing the claim. Of course, in this case the costs of reviewing NNS's unprecedently large claims have been enormous.

3. A Detailed Analysis Of The Ventilation Control Air System Claim Based Upon The Contract Documents

The final claim narrative on the VCAS submitted by NNS is included in the appendix as Ex. #5. The heart of the narrative is set forth in the introductory paragraph:

> 5.2.8 Control Air System
>
> Section 9890-1a, PROPULSION: NUCLEAR POWER, General, of the specifications, provides that two reactor plants similar to those provided in the DLGN 36 Class will be installed in the DLGN 38 Class. As the opening statement in the specification section governing nuclear power, the Contractor had the right to assume, and did assume, that the reactor plant design for the DLGN 38 Class would be similar to that employed in the DLGN 36 Class. This same specification section, 9890, provided that reactor plant ventilation system fans, filters, valves, and instruments shall be in accordance with Government furnished Contract Guidance Plan DLGN 38800-4375731. Although this plan was available to the Contractor at the time of definitization of the contract by Contract Modification P00007, with an effective date of December 21, 1971, it could not then be recognized that it was so vague and misleading as to be deficient for either proposal or performance purposes. Specifically, with the exception of the high pressure (HP) air system, these documents did not reveal the extent of any changes in the design of the DLGN 38 reactor plant ventilation control air system; and as a result, the contract was definitized with only the changes in the high pressure air portion included in the Contractor's pricing. The balance of the control air system was considered to be similar to that incorporated into the DLGN 36 Class ships; that is, it was considered that the control air system would be a small non-nuclear system serving the reactor compartment ventilation valves and not an extensive and enlarged nuclear system serving the reactor compartment isolation and diverting valves.

The thrust of Claim 5.2.8 is that because of misleading language in the contract specifications, and a "vague and misleading" government furnished guidance plan, NNS was misled when it prepared its bid into thinking that the Control Air System on the DLGN 38 would be a small non-nuclear system similar to the system the Yard built on the predecessor class of cruisers (DLGN 36-37). But a careful review of all the relevant specifications and the guidance plan for the VCAS belies the Yard's allegations. The following provisions from the DLGN 38 specifications are critical to our analysis:

Section 9890-I-a provides that

> [t]wo reactor plants similar to those provided in DLGN 36 Class shall be installed in accordance with working drawings...[t]hese working drawings ... shall be used without deviation unless specifically approved by NAVSHIPS 08 or its designated representative.[18]

Section 9890-1-b provides that

> [t]he Government furnished working drawings will be based on contract drawings and contract guidance drawings and will cover the following areas:
>
> 1. Reactor plant fluid systems as defined on Contract Guidance drawings DLGN 38 800-4385710 through 800-4385731.[19]
>
> 2. Reactor compartment ventilation and blowoff system....

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[18] All the relevant specifications relating to the reactor compartment Ventilation Control Air System are included in the appendix as Ex. 13.

[19] Hereafter guidance plans (also known as guidance drawings) shall be referred to by their last three digits.

Section 9021-1-b defines contract guidance drawings as "NAVSHIPS drawings forming part of the specifications [which] serve as an illustrative guide for developing working drawings." As our Navy experts explain, contract guidance drawings are supplied to a contractor as part of the bid package so as to assist him in preparing his bid. [redacted]

Section 9020-1-d of the specifications identify all the hull contract guidance drawings separately by number and description. Of particular significance is guidance drawing #731 for the Reactor Compartment Ventilation Control Air System. Section 9020-1-d also identifies other guidance drawings that relate either directly to the VCAS itself or have significance in the analysis of the integrity of the claim narrative. They are:

Diagram #723 - Reactor Compartment Containment Pressure Control System

Diagram #732 - Reactor Compartment Ventilation and Blowoff System

Diagram #765 - Diagrammatic Arrangement of Compressed Air Systems

The lead-in sentence to the listing of the guidance drawings provides: "The following contract drawings and contract guidance drawings form part of these specifications."

The specifications dealing with the ships' high pressure air system in Section 9490-1 provide:

> Reactor Plant Air System - Supplies from the high pressure air system shall be provided to serve the reactor plant control air system and reactor plant ventilation control air system. These

> connections and associated reducing stations shall be in accordance with 9890-1. [Emphasis added.]

NNS relies heavily upon the word "similar" appearing in Section 9890-1-a. Needless to say, the word similar does not mean the same. As discussed above, the reactor compartment ventilation system, which the Control Air System serviced, was significantly upgraded on the DLGN 38 from its predecessor version on the DLGN 36. Contrary to the suggestion in Claim 5.2.8, NNS appreciated this fact and prepared its bid estimates for most of the upgraded features of the reactor compartment ventilation system and related systems accordingly. This is documented in their estimate sheets.

For instance, as our Navy experts explained, contract guidance plan #732 covers the entire reactor compartment ventilation system; it lists all the valves needed for the system. NNS prepared a bid on all 14 valves. As previously discussed, the number of valves on the DLGN 36 was less than half those required on the DLGN 38. In addition, the latter valves were bigger and more complicated than those on the DLGN 36. Contract guidance drawing 732 specifically mentions the Control Air System. Annotations appearing on drawing 732 direct the reader (estimator) to the specifications book, which in turn refers the reader back to guidance plan 731.

The Ventilation Control Air System on the DLGN 38, unlike that on the DLGN 36, was to be built according to non-deviation working drawings which were to be prepared and furnished the Yard by the Navy's design agent, Electric Boat, the reactor plant lead yard (RPLY) located at Quincy, Mass. Unlike the DLGN 36, a separate guidance plan for the VCAS, drawing 731, was furnished NNS by the Navy in a bid package. Section 9890-1-b specifically identifies guidance drawing 731 as "nuclear;" indeed, that Section is titled "Propulsion: Nuclear Power." The title block on drawing 731 shows it was prepared by the RPLY; the Navy approval signature on the drawing includes the words "Naval Ship Systems Command - 08" -- the designation for Admiral Rickover's command, which has responsibility for all the nuclear systems on the ships. Thus, NNS' assertion that it thought the VCAS was a small, non-nuclear system is palpably false.

The Yard admits in Claim 5.2.8 that it included the high pressure portion of the VCAS in its bid, but states that "these documents [*i.e.*, the specifications and guidance plan 731] ... did not reveal the extent of any changes in the design of the DLGN reactor plant Ventilation Control Air System." This statement is false.

Our Navy experts explained that air from the DLGN 38's high pressure air system was needed to serve the upgraded reactor compartment Ventilation Control Air System (VCAS). This was not the case on the DLGN 36, which used low pressure air only to service its less complicated VCAS.[20/]

[20/] Specification Section 9490-1-d provided only that the DLGN 36 ships' "high pressure air system shall ... serve the reactor plant control air system." By contrast, specification Section 9490-1 for the DLGN 38 class ships made it clear that the high pressure air system was to service *both* the reactor plant control air system *and* the reactor plant Ventilation Control Air System (VCAS).

NNS must have recognized the upgraded character of the VCAS on the DLGN 38's because it included the high pressure air system component of the VCAS in its bid for the DLGN 38 ships.

Guidance plan 765 covers the compressed air system for the entire ship. Guidance plan 765, like guidance plan 732, ultimately refers the reader back to plan 731. A Yard cost estimator named [redacted] was tasked to prepare the estimate for the DLGN 38's entire compressed air system including the high pressure air component. Our Navy experts provided us with copies of [redacted] estimate sheets. These estimate sheets unequivocally demonstrate that [redacted] read and prepared a portion of his bid for the vessel's high pressure air system from guidance plan 731. [redacted] estimate does not include the bulk of the VCAS system detailed on 731 i.e., the low pressure portion of the system. As we learned through the [redacted] investigation~~s~~, the remainder of the VCAS was considered to be another estimator's responsibility. In sum, NNS was aware of plan 731 and that plan was not defective because [redacted] read and studied the plan and was able to prepare an accurate cost estimate of that portion of the VCAS system assigned to him without any trouble. NNS' allegation that guidance plan 731 was "vague and misleading" and thus inadequate for bid purposes is simply without foundation.

Our Navy experts also drew to our attention a system that was subsequently deleted from the DLGN 38, the "containment pressure control air system". Its guidance plan is identified in the specifications as 723. The Navy experts advise us that guidance plan 723 is very similar to guidance plan 731 for the VCAS. [redacted] NNS cost estimato[redacted] was tasked to prepare the estimate for the system covered by drawing 723.21/ The Navy experts indicate tha[redacted]estimate sheets for the system reflected on guidance drawing 723 reveal a great deal of precision. The point is tha[redacted]s able to prepare a very accurate bid for a system similar in design to that of the VCAS on the basis of a guidance plan (723) very similar to plan 731 for the VCAS.

[redacted] At our request, he redid his estimate for the containment pressure control air system, using guidance plan 723. Schiller agreed that guidance drawing 723 provided him with adequate detail to prepare his estimate for valves, fittings, piping, flanges, hangers and stores. [redacted]

Although [redacted] would not comment on guidance plan 731's adequacy for bid preparation, the Navy experts assure us that

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21/ [redacted]

it is just as adequate as 723 -- and we can easily prove that with expert testimony.

In summary then, the Yard's own engineers, present and former, put to rest Claim 5.2.8's allegations that guidance plan 731 was so "vague and misleading" as to be inadequate for bid purposes, and that this diagram, together with misleading language in the written specifications, indicated a small non-nuclear system, rather than an upgraded nuclear system.

Claim 5.2.8 alleges that the VCAS was an "evolving" system and that the first "meaningful indication" of the size of the system (compared to that on the DLGN 36) did not become apparent until July 1973, when the Yard received Rev. B, a working drawing. The claim narrative indicates that NNS recognized material changes on this working drawing, notified the Navy and ultimately negotiated a supplemental agreement with the Navy for certain of the changes. Claim 5.2.8 states that when the Yard was preparing its estimate for the "out of scope" work detected on Rev. B, it was unable to fully claim for all the added costs to the VCAS because the Navy furnished design data was "so incomplete and ambiguous as to preclude meaningful analysis," and because the working drawings failed to indicate piping lengths required in the VCAS. These allegations are also false.

The Navy engineers who prepared the CITAR on Claim 5.2.8 have carefully retraced the chronology of events, including all communications between the Navy and the Yard, and have destroyed NNS' allegations of "system evolution." [redacted]

The Navy CITAR shows that on May 30, 1972, the Yard notified the Navy that the working drawing for the VCAS was overdue and urgently needed. The Navy responded on June 5, 1972, by furnishing a working drawing with a level of detail much greater than on the guidance plan. In June 1973, the Navy issued another working drawing, Rev. B.[23] Rev. B added high pressure air reducing stations to the VCAS that were not found on guidance plan 731. On August 30, 1973, the Yard sent TWX 107 to the Navy advising that it considered the additional material (*i.e.*, added reducing stations) beyond the scope of the contract. The important thing to note here is that TWX 107 listed *only* the added reducing stations as a constructive change entitling it to added compensation. TWX 107 explicitly states that the Yard carefully compared Rev. B. with guidance plan 731 in arriving at its conclusion:

> 1. Newport News review of (EB Dwg. 38643-01X01) reveals *materials* specified which are not on *contract guidance drawing 800-4385731*.
>
> 2. Newport News considers the additional material on (EB Dwg. 38643-01X01) will involve work beyond the scope of contract N00024-70-C-0252.
>
> 3. Newport News is preparing an order-of-magnitude estimate of the additional cost and will inform NAVSHIPS by separate communication.

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[23] Rev. B. was prepared by the Navy's design agent, Electric Boat Division, of Quincy, Mass. Rev. B. is referred to by NNS as E[lectric] B[oat] Drawing 38643-01X01.

As a result, on September 26, 1974, the Navy authorized the contracting officer to negotiate a contract modification to include the air reducing stations not shown on guidance plan 731.[24] On November 14, 1974, the Navy and Yard executed MOD A00468, a bilateral supplemental agreement incorporating the changes authorized by HMR-145.

On October 1, 1974, and November 21, 1974, the Navy issued NNS detailed installation working drawings for the Ventilation Control Air System. These drawings detailed the exact routing of piping, piping dimensions, and exact installation locations for mounting VCAS components. As the CITAR, Ex. #14 underscores at p. 25:

> These detailed drawings could not have been developed until information on the shipbuilder's components and structure had been received from the shipbuilder to enable the RPLY to work out a satisfactory design in conjunction with the shipbuilder. It is noted that these drawings were to be provided "as they become available" in accordance with the terms of the contract. The drawings were provided as early as receipt of satisfactory shipbuilder information reasonably allowed.

Claim 5.2.8 seeks compensation for installing components listed both on the original guidance plan and the two subsequent detailed working drawings. But if the Yard actually considered any of these components -- other than the added reducing stations -- to be new or otherwise outside the scope of the contract, it clearly would have promptly notified the Navy of that fact, as required by the changes clause of the contract. The fact that the Yard failed to make any other claim contemporaneous with its claim for the added reducing stations is persuasive evidence that it did not consider the working drawings to have added anything to the original guidance plan for which the Navy was required to pay additional compensation.25/

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[24] HMR-145 at paragraph R. HMR means Headquarters Modification Request.

In sum, Claim 5.2.8's theory of an "evolving design" in the VCAS is without foundation[redacted] The claim narrative indicates that NNS cost estimators actually read and relied upon the Navy's guidance plan and specifications in helping to prepare NNS' contract bid, and that NNS' bid did not take account of the true cost of the VCAS because of deficiencies in the documents supplied by the Navy. However, in reality, the Yard, through mismanagement, simply overlooked the bulk of the VCAS system in preparing its bid. Thus, whether or not the documents supplied by the Navy were vague or misleading is

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25/ [redacted]

actually beside the point because NNS employees, with the exception o[redacted] never even looked at them. In any event, as we have shown, the documents supplied by the Navy were perfectly adequate to enable the Yard to prepare an accurate bid, had it taken the trouble to read them.

V. OTHER FALSE CLAIM ITEMS UNDER INVESTIGATION

1. OSHA and EPA Claims

NNS alleges in Claim item 5.9.2 on the DLGN 38-40 cruiser contract that it incurred increased costs due to government actions, specifically, the passage of environmental legislation including the Clean Air Act of December 1970 and the Water Pollution Control Act Amendments of October 1972. Claim item 5.9.3 on the cruiser contract alleges that Newport News incurred additional costs due to the government's passage of the Occupational Safety and Health Act of 1970.

NNS alleges that since the contract negotiations were based upon its September 15, 1970 bid proposal, no consideration was given to the impact of the subsequent Clean Air Act or Water Pollution Control Act Amendments. NNS also alleges that since OSHA was not established until April 1971, no consideration was given to the impact of OSHA on the proposed contract.

Claim item 5.9.2 (Added Environmental Control Requirements) states, in pertinent part:

> In December of 1970, the Environmental Protection Agency was established and under the authority of the amendments, the emission standards were subsequently promulgated. The federal water pollution control act amendment was enacted during 1972 (October). During this same period, actions were under way which would lead to definitization of the contract. Since the negotiation in progress was of the 1970 proposal, no consideration was given by

> either contracting party to the impact of the Clean Air or Water Pollution Control Act Amendments upon the proposed contract.

Claim item 5.9.3 (Occupational, Safety and Health Act of 1970) states, in pertinent part:

> During the same period [December 1969 - December 1971], the Government enacted the Occupational Safety and Health Act (OSHA) in April of 1971. Since the negotiation in process was of the contractor's 1970 proposal, no consideration was given by either contracting party to the impact of OSHA upon the proposed contract. In this section of the proposal, the contractor will show that OSHA did have an effect upon the performance of this contract, what that effect was, and that the Government, in the contract, had agreed in such cases to an equitable adjustment.

The claims then set out NNS' argument as to why these added costs should be passed on to the government, including the steps the Yard took in order to comply with the new legislation.

The original bid proposal was submitted by NNS in response to the RFP and guidance plans which were sent to NNS in November 1969. The original NNS bid proposal was submitted on September 15, 1970. However, on July 23, 1971, a supplemental proposal was submitted by the Yard. In its July 1971 bid proposal, the Yard attributed a direct cost of $3,700,608 plus 2.4 percent of overhead (amounting to $2,556,000) for compliance with OSHA and EPA requirements.41/ Schedule E, attached to the July 1971 bid proposal, reads as follows:

41/ Thus, the total amount of money included in the bid proposal for compliance with OSHA and EPA requirements was $6,256,608.

> The proposed target costs for these ships includes $1,870,591 for the DLGN 38, $987,675 for DLGN 39, and $932,338 for the DLGN 40 to cover the estimated impact of current laws such as the Occupational Safety and Health Act of 1970 and Environmental Control legislation on direct costs and associated overhead. Estimated costs were derived by applying a 2 percent factor to all productive (including supervision) hours plus associated overhead to reflect the loss of efficiency, expected due to the necessity of operating under the adverse constraints. Also included for each ship is an estimated $50,000 for miscellaneous consumable materials.
>
> The proposed overhead rate includes 2.4 percent to cover additional and direct costs estimated to be incurred as a result of the legislation. The additional overhead was derived by evaluation of the capital expenditures required, cost of indirect labor, lost direct labor hours for various medical examinations, record keeping and other miscellaneous costs.42/

Thus, it is crystal clear that, contrary to the representations made in claim items 5.9.2 and 5.9.3, consideration was given to possible increased costs due to EPA and OSHA requirements.

It is important to note that even if the Yard's OSHA and EPA claims were factually correct, they would still lack any legal foundation since it is firmly established that the United States as a contractor cannot be held liable directly

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42/ Apparently, there was further communication between the Navy and NNS regarding these additional costs. In a memorandum dated August 11, 1971, to the Defense Contract Audit Agency, the Yard responded to a number of questions raised by the Navy regarding the July 1971 proposal. The letter is signed by a J. E. Ware, Assistant Cost Engineer, with copies to Mr. E. A. Brown, D.C.A.A.; Mr. C. L. Willis; Mr. C. E. Dart; and the Cost Engineering Department.

or indirectly for public acts of the United States as a sovereign.[43/] Horowitz v. United States, 267 U.S. 458 (1925); Sun Oil Co. v. United States, 572 F.2d 786, 817 (Ct. Cl. 1978); Tony Downs Foods Co. v. United States, 530 F.2d 367, 370-371 (Ct. Cl. 1976); Glasgow Associates v. United States, 495 F.2d 765, 770 (Ct. Cl. 1974); Reynolds Metal Company v. United States, 438 F.2d 983, 987 (Ct. Cl. 1971); J.A. Jones Construction Co. v. United States, 390 F.2d 886, 887 n.3 (Ct. Cl. 1968); Wunderlick Contracting Co. v. United States, 351 F.2d 956, 967 (Ct. Cl. 1965). The fact that the OSHA and EPA claims lacked even a colorable legal basis is another indicium of NNS' lack of good faith.

43/ The government can agree in a contract that it will do no sovereign act that would hinder the private contractor in the execution of the contract and that if it does so, it will pay the other contracting party the amount by which its costs are increased by the government's sovereign act. Amino Brothers Company v. United States, 372 F.2d 485, 491 (Ct. Cl. 1967). However, the cruiser contract has no such clause. In its OSHA and EPA claims the Yard maintained that the contract did in fact contain such a clause. The Yard cited Clause 75, entitled "Health, Safety and Fire Protection", which was added to the cruiser contract by Supplemental Agreement P00007 on December 21, 1971. But the Yard ignored the fact that Clause 75 is limited to increased costs caused by compliance with new regulations and requirements "with respect to the risks described in the Article of this contract entitled 'Nuclear Risk -- Indemnification Under P.L. 85-804.'" The Yard's claim narratives quote Clause 75 selectively in order to give the misleading impression that the sovereign act provisions relate to all government health and safety regulations.

2. Navy Recruiting Claims

NNS alleges that it encountered unanticipated costs of $23,723,192.00 in the performance of its contracts on the 14 vessels as the result of Navy recruiting practices. This figure was divided equally amongst the 14 ships in the amount of approximately $1.7 million each.

The claim alleges that "the contractor incurred added costs for recruiting, hiring and training of new and replacement employees as well as added costs to adjust workloads as a result of the unanticipated departure of employees who were recruited by the federal government." It further alleges that the government's promotional advertising had a direct effect upon the loss of employees to the government, specifically the Norfolk Naval Shipyard. The loss of employees was primarily due to the Navy's intensive recruiting campaign during May and June 1974.

In order to fulfill its contractual obligations during the period January 1, 1973, through October 31, 1974, NNS had to maintain a level of employees sufficient to perform the contracts on the 14 ships. Therefore, it claims it mounted an extensive recruitment effort.44/ In approximately 10 pages of claims narrative NNS sets out its recruiting efforts to attract

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44/ During this same period, Newport News was diverting some of its employees for the purpose of constructing oil tankers at its new civilian Yard. It fails to mention this fact in its narrative.

hourly employees, and design and salaried employees. The narrative is written in such a way as to lay blame on the Navy for NNS' difficultly in obtaining the results it desired from its recruiting efforts. Although NNS asserts that 10,493 employees voluntarily resigned from January 1, 1973, through October 31, 1974, it was only able to determine that 342 of those employees were taking jobs with the Navy. There were, however, no specific reasons given why those employees left Newport News, or why they joined the Navy. The figure of 342 represented those employees who indicated that they were leaving for the Navy out of the 4,722 who had agreed to give exit interviews. NNS calculated that 720 employees left the Yard to join the Navy, based on an extrapolation from the 342 employees known to have joined the Navy.

The thrust of the claim is that as a result of Navy recruiting efforts a number of employees left NNS to take positions with the Navy. Consequently, in order to maintain its workforce, NNS had to recruit new employees. In order to maintain the level of proficiency of its employees, training and recruiting costs were incurred. NNS based its calculations on a figure of $25,000 training costs for a skilled union employee and $35,000 for a salaried or design employee. These calculations were premised upon the recruitment of employees with a zero skill level, and a five-year training period. Furthermore, the figure included salary costs while the new employee was doing productive work.

This claim seems ripe for further investigation because the legal theory of entitlement is completely spurious for the same reason that the OSHA and EPA claims are -- it ignores the sovereign act doctrine; and the training and recruiting costs are calculated in a fashion that shows a conscious disregard for the truth.

1. Many vacancies were created by voluntary terminations of employees with little experience. Consequently, a new employee could be trained to that relatively low level of proficiency at minimal cost. The number of terminations claimed during the period included terminations of all employees, skilled and unskilled summer help, janitors and secretaries.

2. Many of the vacancies were filled by rehires who needed minimal training. For example, in 1973, NNS filled 38.6 percent of its vacancies with rehires and in 1974, 45.7 percent.

3. Newport News failed to mention that the Navy also loses skilled employees to Newport News, thus reducing NNS' training costs.

4. Newport News states in its claims narrative that costs due to Navy recruiting were unanticipated. However, it is clear that the Yard has historically lost employees to the Navy.

5. NNS did not compare the size of its claim with its actual recruiting and training costs to verify the accuracy of the estimate.

6. No base period of comparison was established to show whether there was an increase in terminations during the claim period due to intensified Navy recruiting activity.

7. A Yard employee who worked on the training costs came up with a figure of $24,000 per union skilled employee and $31,000 per design and salaried employee while in its claim NNS used a higher figure resulting in an overall increase of $1.7 million.

That NNS' claims in this area are grossly exaggerated is shown by the fact that were NNS to calculate its retraining costs for all job vacancies at the same rate it calculated its retraining costs allegedly attributable to Navy recruiting, the amount would be more than $333 million, a sum equal to 55.6 percent of NNS' total direct and indirect labor costs for its work force of 24,000 plus employees.

3. Claim Item VII.B.8 (Bow Dome) and Claim Item VII.B.9 (Cathodic Protection) in NNS' Proposal for Equitable Adjustment on the 688 Class Submarines

The prosecution report prepared by the initial investigative team addressed these two claim items at some length. The Yard's claims on these two items are devoid of merit -- a conclusion concurred in by the initial investigative team.

It will be recalled from the initial pros report that the sequence in the initial preparation, filing, rewriting and refiling of these two claims was virtually identical.[45] The claim narratives for both items, as initially written and filed with the Navy, were based upon an erroneous premise -- that the Yard prepared its bid on the two items after the new ship estimators reviewed Navy-furnished specifications and mistakenly concluded therefrom that a particular method (welding) was required for installation of both items. The Yard later learned, after receiving Navy-furnished working drawings, that a more expensive installation method (bolting) would be required. According to the initial claim narratives, these "changes" resulted in government-responsible cost overruns on both items. As with the VCAS claim on the DLGN 38-40 cruisers, the Yard's theory of entitlement for these two claims was predicated upon the "constructive change order" doctrine.

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[45] NNS filed what was described in the earlier pros memo as a "mini-claim" on the 688 submarines in 1975, expecting a quick settlement. When settlement discussions failed, NNS filed a claim in 1976 for twice the amount. That claim is described as the "maxi-claim" in the first pros report.

[redacted] The rewritten claims contain material omissions of fact and state a spurious theory of entitlement bearing no relationship to the historical events leading to the Yard's cost overrun on these two items.

The reviewers in the Department have the initial prosecution memorandum with attachments for these two claims, as well as the spade memos for these claims prepared by Assistants in the United States Attorney's Office in the Eastern District of Virginia.

4. Discharge Sea Chests Claim

NNS claims that it encountered three areas of added work and increased costs in connection with the reactor plant hot discharge sea chests on the DLGN 38-40, the cruiser contract, which were not contemplated by the parties. This added cost allegedly resulted from deficient specifications and/or deficient Navy data.

Discharge sea chests are openings in the ship's hull from which cooling water or other fluids used internally in the ship are discharged. The sea chests discussed in the claim are only in the reactor plant systems. Because discharges via the sea chests are of high velocity, and elevated temperatures, they may cause accelerated corrosion.

The claim concerns three specific areas involving the discharge sea chests. First, the sea chest material was changed from steel to monel; second, thermal sleeves were and, third, welding instructions on the working drawings were allegedly vague, unclear or incomplete, causing rework of previously welded components.

Because of the corrosion problems, the design of the sea chests was changed on the CVN 65 (U.S.S. ENTERPRISE). The Navy, in March 1969, had its design agent, NNS, redesign the sea chests in order to minimize the effects of the discharge. NNS recommended and the Navy concurred in the installation of monel sea chests with thermal sleeves for the carrier in 1969, and NNS assisted in the installation of eight monel sea chests with thermal sleeves in the U.S.S. ENTERPRISE during October 1969.

As part of the DLGN 38 bid package, NNS had the specifications and contract guidance drawings in November 1969. The contract guidance drawings, 722, 729 and 730, showed that monel sea chests with thermal sleeves would be required. The three drawings indicated by a detailed enlargement or legend note, or both, that the coolant discharge sea chests, steam generator release valve discharge sea chests, and the steam generator blow down sea chests, "shall contain 'thermal sleeves', shall be monel, and shall be welded integral with the hull." On two of the guidance drawings, an arrow points to the sea chests, and the words "THERMAL SLEEVES" appear, together with a drawing of the sleeves. On another, 722, alongside the symbol for the sea chests, are the words "See note 31." Note

31 states that "in lieu of flanged sea valve a flange spool piece shall be located downstream of sea valve to allow removal of sea chest thermal sleeve." The three drawings on the DLGN 38 also indicate, by detailed enlargment, a thermal sleeve extending beyond the exterior of the ship's hull. A comparison between the DLGN 36 and DLGN 38 contract guidance drawings shows that the DLGN 36 drawings bear the notation "waster piece" where the DLGN 38 drawings note "thermal sleeve". The diagram on the DLGN 36 drawings indicates a waster piece that does not project beyond the exterior of the ship's hull.

Furthermore, on September 7, 1971, the reactor plant lead year (RPLY) issued the working drawings for monel sea chests and thermal sleeves for the DGN 38. They were entitled, "Discharge Sea Chests . . . Nuclear." It is clear from the Yard's acknowledgement of receipt of those drawings that they were in the Yard's possession on September 10, 1971, prior to bid and contract definitization. The drawings set out the type of sea chests that the DLGN 38 class ships were required to have. However, with regard to the steam generator bottom blow sea chests (2 of 8), the design was indicated to be monel with thermal sleeves but the drawing was "reserved."

A review of paragraph 9480-0-A of the cruiser specifications indicates that Section 9480 -- which specifies that the hull be made of steel, a less expensive metal than monel -- is not applicable to reactor plant sea chests unless noted elsewhere. Thus, contrary to NNS's position, there is no conflict between the working drawings and Section 9480. Furthermore, a comparison of the specifications for the DLGN 36, 38 and CVN 68 indicates that the words of Section 9480 are similar in all three. Significantly, the CVN 68 was built having monel sea chests with thermal sleeves similar to the DLGN 38. Thus, in building the CVN 68, NNS did not interpret Section 9480 in the same manner as it allegedly did in bidding on the DLGN 38 cruisers.

After receipt by Newport News of the advance copies of the working drawings on September 10, 1971, they were apparently reviewed and material procurement initiated, since on October 1, 1971, LAR 98-9453 (Liaison Action Request) was issued requesting a change in the drawings to facilitate welding. It is clear that the LAR could have been prepared only after a detailed review of the design for the discharge sea chests. On November 3, 1971, also before contract definitization, NNS issued a supplement to the LAR which noted a structural interference between the sea chest flange and a gusset. The supplement stated (after receiving Electric Boat's reply to LAR 98-9453, which permitted the use of a weld neck flange in lieu of a flat plate flange), that NNS had investigated the installation requirements. Thus, it is apparent from NNS' request for a change in the non-deviation drawings that it had reviewed them in detail.

On November 24, 1971, the reactor plant lead yard, Electric Boat, sent NNS the working drawings. They were unchanged from the advance working drawings except for the change asked for by NNS. On December 21, 1971, the contract was definitized.

On April 12, 1974, the RPLY issued revision B to the sea chest drawing for the steam generator blow down sea chests, which earlier had been "reserved". On May 16, 1974, NNS issued a teletype communication (TWX) stating that it considered the cruiser sea chest work to be beyond the scope of the contract because the sea chest designs for all reactor plant sea chests were "significantly more complex" than on the DLGN 36 ships and because NNS had overlooked the fact that they were to be made of monel. NNS stated that it "overlooked" the monel shown in the DLGN 38 guidance drawings when it submitted its bid and only became aware of the complexity of the sea chest design on April 12, 1974, when Rev. B of the sea chest drawing was received. On October 16, 1974, the government responded by setting out the above mentioned chronology of events, which clearly indicated that NNS knew or should have known of the DLGN 38 design for the discharge sea chests and rejected its contention that it was beyond the scope of the contract. It is clear that NNS was seeking government payment for its own oversight both in its TWX and in the claim. After the government's response to the TWX, nothing further was heard from NNS on the matter until the claim was filed in August of 1975.

The thrust of the portion of the claim concerning weld joint numbers is that the RPLY failed to include such numbers in the drawings it supplied to NNS. However, weld joint numbers are simply not required, although they are often included to draw attention to particularly important welds. NNS was required to make welds that would meet standard inspection requirements regardless of whether weld joint numbers were included.

In sum, there can be no dispute that, prior to contract definitization, NNS had specifications and contract guidance drawings that clearly indicated that the discharge sea chests were to be constructed of monel with thermal sleeves. NNS' recognition of this requirement is shown by its issuance of LAR 98-9453 and the supplement thereto, which requested a change in the advance copy of the sea chest working drawings that had been received by NNS on September 10, 1971. If NNS missed the bid on the discharge sea chests, it was clearly the result of its oversight, as NNS conceded in its TWX issued on May 16, 1974. NNS' claim that its cost overrun was due to deficient government supplied guidance drawings and specifications is knowingly false.

5. Added Interest or Financing Costs

In all of its proposals, NNS claims equitable adjustment for interest or financing costs. NNS asserts that the Navy failed to make progress payments in sufficient amounts for change work caused by the Navy, thus requiring it to provide financing for such additional work. The financing claims totalled $50,473,275 excluding the DLGN 36, 37, 41 and 42.

A common thread runs throughout each of the narratives.[46] The claim on the DLGN 38, 39 and 40 states in pertinent part:

> Had the billing base been adjusted to cover the changes, and had progress payments been forthcoming as contemplated by the contract, the contractor would either have reduced his short term bank borrowing or increased his investments.

The amount of each claim was calculated similarly. On a monthly basis, NNS took the cumulative cost of building the ship as of the end of that month and added five percent.[47] NNS then subtracted all Navy payments to date, which resulted in a figure, "loss of revenue", to which was added the cumulative prior months' interest. This figure was then multiplied by 115%. (This percentage was used because NNS claimed that a compensating balance of 15% had to be maintained on deposit at a bank in order to qualify for loans at the prime rate.) This figure was then compared to NNS' actual average monthly borrowing for the entire Yard. Interest was then calculated on the of the two figures. But if the average NNS wide borrowings were less than the loss of revenue, the difference was used to calculate the interest on investments that could have been made if the Navy was paid for the change work on time.

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[46] In each claim, NNS indicated that its financing costs were not traced to any specific ship contract.

[47] We do not know what the 5% add-on represents.

Additionally, on the submarines SSN 686 and 687 claim narrative, NNS stated that it claimed adjustment for additional financing costs incurred as a result of changes in FICA.

While NNS' theory of entitlement may be correct here, the methodology used in calculating the interest or added financing costs again indicates a total disregard for the truth. First, NNS simply assumed that all cost overruns were the result of Navy actions. It made no attempt to distinguish between cost overruns that might be attributable to the Navy and those that were so clearly not the Navy's responsibility that it never even sought compensation for them. Second, NNS calculated its borrowings based upon the prime interest rate when in fact it borrowed substantial sums from its parent company, Tenneco, at less than the prime interest rate. Because no compensating balance was required by Tenneco, the 115% multiplier should not have been used on monies borrowed from Tenneco. Apparently, NNS' calculations also improperly excluded escalation payments on the DLGN 36 contract. Excluding these escalation payments increased the difference between payments made by the Navy and NNS' monthly cost overruns. Finally, NNS is claiming interest on its administrative time lag in requesting progress payments. Elimination of the time lag element, i.e., the time used to prepare and present a claim to the Navy for progress payment after the work was performed on the DLGN 38-40 contract, results in a decrease of $1,442,589.00 in the claim amount.

also multiplied by Ceiling to Target ratio as though! all costs had been considered

6. Reactor Shielding Claim

NNS claims that it encountered unanticipated problems in building the reactor shielding on the DLGN 38-40 series of cruisers due to alleged deficiencies in the government-furnished design. According to the claim, the design did not allow for adequate dissipation of the heat generated during installation of lead shielding. Moreover, the design required NNS to fabricate certain lead panels in a more complex manner than necessary and the Government did not approve NNS' recommended simplification until too late. Consequently, NNS was entitled to costs arising from its investigation of the problems, including engineering efforts to recommend design changes, a mock-up fabrication, and additional production efforts to implement the recommended design changes that corrected the alleged deficiencies. The claim also seeks equitable adjustment for disruption and delay caused by the deficient Government supplied drawings and plans.

The shielding discussed in the claim consists of a primary and a secondary shield. The primary shield surrounds the entire reactor vessel while the secondary shield surrounds the reactor compartment. The shields consist of a cylindrical inner steel wall or bulkhead with a series of vertical and horizontal structural steel stiffener plates (divider plates forming a honeycomb-like array of cells called "bays" on the outside of the cylinder). Lead slabs are installed in each bay and each lead slab is bonded around the perimeter to the steel wall and the divider plates by lead. The melted lead must bond to the steel and fuse to the lead slab. Polyethylene plastic shielding material or a more temperature resistant material known as PPC were required to be installed over the top of the lead sheets. The shield bay is required to be sealed with a steel cover plate that is welded to the divider plates and seals the plastic shielding material within the shield bays.

A. The primary shield may be fabricated essentially as a complete cylindrical assembly in the Yard shop. The secondary shield, which is a larger, heavier structure, cannot be handled in the same manner. Consequently, NNS built the secondary shield in segments and installed the plastic shielding material (polyethylene) in many bays of the secondary shield in the Yard shop before welding the segments together on the ship. Assembly of the segments required that lead and plastic not be installed in the shield bays that contained "erection butts." Erection butts are the welded structural joints which join individual segments of the shielded bulkhead to the ship and to each other. Once these erection butt welds are made, lead and plastic shielding must be installed over them to complete the shield installation.

During construction in late 1972, NNS recognized "a potential problem" with the secondary shield. A mock-up was constructed and a LAR (Liaison Action Request) dated February 8, 1973, was initiated. The problem was that the heat required to join the lead panels in bays containing erection butts was great enough to melt shop-installed polyethylene in the shield bays. A similar problem was recognized by Newport News in the primary shield around the temporary access openings. The mock-up confirmed NNS' concerns and it proposed five ways in which to remedy the problem: (1) install the polyethylene in the bays on board the ship after the erection butts in adjoining bays were connected; (2) use a high temperature polyethylene (PPC); (3) use caulking instead of lead to connect panels adjacent to erection butts; (4) use asbestos sheet insulation to protect the polyethylene; and (5) accept the melting. The RPLY in a series of Plan Revision Notes (PRNs) approved the use of a more expensive heat resistant polyethylene (PPC) at NNS's option.

B. In mid 1973, cracks were discovered in the primary shield while it was being fabricated in the shop. An investigation by NNS revealed that the cracks were due to poor workmanship. NNS assured the Navy that steps would be taken to prevent a possible recurrance.

However, in October 1973, a new problem arose when lead cracks and unbonding were discovered again in the primary shield and also in the secondary shield. NNS first investigated its personnel but "determined" that procedures were in accord with military welding standards and the "contractor's personnel possessed adequate skill and exerted reasonable care." NNS notified the Navy of these problems in December 1973 and

January 1974. The Navy suggested by letter that a similar problem had occurred at other shipyards which "showed the need for including temperature control requirements in the procedures for lead bonding to minimize the costly rework and repair for bond defects." On the same date, NNS recommended either the use of the caulk method (packing of lead between joints) or the installation of doubler plates to provide additional heat sink and heat diffusion. For the first time, in March 1974, in a LAR, the Yard considered the problems to be traceable to "defective specifications" and not poor workmanship.

C. In another part of the claim, NNS asserted that a non-deviation drawing, 842, required lead of varying thicknesses be installed around the periphery of the primary shield tank. In order to accomplish this, NNS had to cast lead slabs in the required thicknesses and join them by bonding. NNS alleged that past experience had shown this to be complicated and expensive. NNS proposed that a standard sized parent slab be installed with a "piggyback" slab welded on to fill in the shield tank. The Navy at first refused because it feared that the requested process change would result in delay. Once the Yard, two and a half months later, provided more details, as well as a proposed drawing revision, the Navy approved the requested change. NNS claims that the change was implemented too late to be used on DLGN 38 and 39 and therefore that it was entitled to compensation for the amount that would have been saved had it been able to use the piggyback method on those two cruisers.

The problems recounted by NNS in this item had nothing to do with defective specifications. The contractor had prior experience with the fabrication techniques and was aware, or should reasonably have been aware, of the fact that excessive heat could result in melted polyethylene and unbonded lead. The applicable shielding drawing, 842, was in the hands of the contractor prior to contract definitization and included certain notes which specified that temperatures for polyethylene and lead were not to exceed specific limits that were classified as confidential.

In addition, for bidding purposes on the DLGN 38, NNS had been given NAVSHIP's drawing 245-4444872. Paragraph 3.1.2 of that drawing stated:

> Plastics [polyethylene] are flammable materials. Normal fire hazard precautions should be observed during handling and storage. During installation when the plastic is located close to welding or burning operations, it should be protected by a flameproof material. Edge bonding of slabs (or other structural work requiring high heat) in adjacent areas must be complete before plastic is installed unless precautions are taken to prevent the possibility of damaging the plastic.

Thus, it is clear that NNS knew prior to definitization of the contract, that the polyethylene layers and lead slabs could be damaged by excessive heat. The fact that excessive heat damage did occur resulted not from the fact that the drawings or specifications were defective, but from the fact that NNS ignored the caveats against excessive heat. NNS attempted to fabricate the shielding layers at too fast a rate, which resulted in excessive heat generation.

Furthermore, the fabrication and installation sequence is not dictated by the Navy through non-deviation drawings, but rather is determined by the contractor. That the Yard was in fact aware of the potential problems at the time of contract definitization is indicated by the fact that it increased the contract price by 60 percent to take account of the anticipated slow rate of fabrication.

It is significant that NNS' original correspondence and LAR did not suggest that the Navy's design specifications were defective. It was only in March 1974 that NNS first indicated that the specifications might be defective and that the work resulting from approval of the LAR "might not be within the scope of the contract." It is interesting to note that March 1974 is around the time that the Contract Controls operation was set up with Willis as its head.

Furthermore, as to the claim regarding the lead fissures, NNS recognized that bonding techniques are an "art" dependent on worker techniques and not susceptible to written specifications. NNS conducted an investigation into the qualifications and performance of its lead burners to determine whether

NNS could reduce the number of defects, thereby saving production costs, and to support NNS's request that the Navy accept defects that could no longer be discovered. It should be noted that after NNS's investigation and implementation of corrective action, no further reports of unbonding or requests for acceptance of lead bond defects were made. Thus, the cost of NNS' investigation of its lead burners should not have been charged to the Navy.

As to the claim regarding the delayed implementation of the "piggyback" method of lead installation on the primary shield, two observations may be made: (1) the requested change was made to facilitate NNS's construction; and (2) the original design was feasible. Besides the guidance drawing, NNS received the non-deviation working drawings on July 27, 1971, prior to contract definitization. Thus, NNS should have recognized a need to suggest any alternate methods which would facilitate its construction. After the initial rejection, NNS waited 2-1/2 months before it submitted further documentation to support its request, which was finally approved.

Another interesting aspect of this claim is that the issue of a contract change for portions of this work was thoroughly and formally documented and discussed between NNS and the Navy at the time. It was apparently resolved in discussions with the Senior Vice President for Contracts and the Vice President for Engineering, who agreed to cancel a prior letter identifying a contractual disagreement and potential request for a contract adjustment. Both the contractor's prior letter and the letter formally withdrawing it were signed by the Director of Contract Controls, Willis. NNS's claim cites the correspondence relating to this matter at length, including the letter identifying the contractual disagreement. However, it omits the fact that the Yard formally cancelled that letter. Thus, besides the possible fraud in the claims write-up regarding NNS's conclusion that the problems resulted from defective specifications, this is another example of an apparently deliberate omission of a material fact that, if revealed, would have cast serious doubt on the validity of the claim.

VI. THE PROPOSALS FOR EQUITABLE ADUSTMENT ARE "CLAIMS" WITHIN THE MEANING OF 18 U.S.C. §287 AND THE STATUTE OF LIMITATIONS DOES NOT BAR AN INDICTMENT BASED ON THE FILING OF THOSE CLAIMS

1. Newport News contends (CM 40-51)[48] that its proposals for equitable adjustment are not "claims" within the meaning of 18 U.S.C. §287 and that it is therefore not subject to prosecution under that section of the criminal code. This contention is frivolous.

The forerunner of Section 287 was enacted in 1863, as part of the False Claims Act, "following a series of sensational Congressional investigations into the sale of provisions and munitions to the War Department." United States v. McNinch, 356 U.S. 595, 599 (1958). As the Supreme Court explained in McNinch (ibid.),

> [t]estimony before the Congress painted a sordid picture of how the United States had been billed for nonexistent or worthless goods, charged exorbitant prices for goods delivered, and generally robbed in purchasing the necessities of war. Congress wanted to stop this plundering of the public treasury.

Although the False Claims Act (hereinafter "the Act") was enacted specifically to prevent military contractors from plundering the public treasury (see also 356 U.S. at 599-600, n.9), the statute's prohibitions have been broadly applied "to reach any person who knowingly assisted in causing the government to pay claims which were grounded in fraud." United States ex rel. Marcus v. Hess,

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[48] "CM" refers to the Confidential Memorandum recently submitted by Newport News Shipbuilding and Dry Dock Company to the Department of Justice.

317 U.S. 537, 544-545 (1943). "Debates at the time suggest *the Act was intended to reach all types of fraud, without qualification, that might result in financial loss to the Government.*" *United States* v. *Neifert-White Co.*, 390 U.S. 228, 232 (1968)(emphasis added).

The Supreme Court "has consistently refused to accept a rigid, restrictive reading" of the Act, even though it "impose[s] criminal sanctions as well as civil." *Ibid.* For example, in *United States* v. *Neifert-White Co.*, *supra*, a civil action to recover statutory forfeitures, the question was whether the Act applied to the supplying of false information to the Commodity Credit Corporation in support of a loan application. The district court dismissed the action on the ground that an application for a CCC loan, as distinguished from a claim for payment of an obligation owed by the Government, is not a "claim" within the meaning of the Act. The court of appeals affirmed the district court's decision but the Supreme Court unanimously reversed. The Court held (390 U.S. at 233; emphasis added) that *the statute "reaches beyond 'claims' which might be legally enforced*, to all fraudulent attempts to cause the Government to pay out sums of money." The Court distinguished its prior decision in *United States* v. *Cohn*, 270 U.S. 339 (1926), on the ground that *Cohn* involved a fraudulent application to obtain the release of merchandise which belonged to the claimant and which was being held by the customs authorities as bailee only. The Court observed (390 U.S. at 231; emphasis added) that *Cohn* "did not involve an attempt, by fraud, to cause the Government to part with its money or property, either in discharge of an obligation _or in response to an application for discretionary action_. 49/

The breadth of the Act is also illustrated by the Court's decision in _United States ex rel. Marcus_ v. _Hess_, _supra_, a qui tam or informer suit brought in the name of the United States. The respondents were electrical contractors employed to work on P.W.A. projects in the Pittsburgh area. Their contracts were made with local governmental units rather than with the United States government, but a substantial portion of their pay came from the United States. Respondents submitted monthly estimates for payment to the local sponsors on P.W.A. forms. While the estimates themselves were apparently truthful and accurate, the contract price was inflated because of a prior collusive bidding scheme. The Supreme Court held that the monthly estimates were fraudulent claims "well within the prohibition of the statute." 317 U.S. at 542. The Court explained _(id._ at 543-544):

> The government's money would never have been placed in the joint fund for payment to respondents had its agents known the bids were collusive. By their conduct, the respondents thus caused the government to pay claims of the local sponsors in order that they might in turn pay respondents under contracts found to have been executed as the result of the fraudulent bidding. This fraud did not spend itself with the execution of the contract. Its taint entered into every swollen estimate which was the basic cause for payment of every dollar paid by the P.W.A. into the joint fund for the benefit of respondents. The initial fraudulent action and every step thereafter taken pressed ever the ultimate goal - payment of government money to persons who had caused it to be defrauded.

49/ See also _United States_ v. _Mastros_, 257 F.2d 808,809 (3d Cir.), _cert. denied_, 358 U.S. 830 (1958), holding that a settlement proposal was a "claim" against the Army within the meaning of Section 287 because it "sought the collection of money from the U.S. Treasury."

The Court added that the Act was intended to provide broad protection against those who would "cheat the United States", and that "the fraud here could not have been any more of an effort to cheat the United States if there had been no state intermediary." *Id.* at 544.

While the foregoing cases demonstrate that the statutory term "claim" has been interpreted broadly to reach "all fraudulent attempts to cause the government to pay out sums of money" (*United States* v. *Neifert-White, supra*, 390 U.S. at 233), it requires no such broad interpretation to encompass the conduct involved here. Rather, Newport News' proposals for equitable adjustment lie at the very core of the conduct Congress sought to proscribe in the Act.

Newport News concedes (CM 41), as it must, that the proposals "assert[ed] the right to receive compensation from the government." Moreover the changes clause of the contract with Newport News (Article 29) uses the terms "claim" and "equitable adjustment" interchangeably.50/ See *United States* v. *Wertheimer*, 434 F.2d 1004, 1006 (2d Cir. 1970). Nonetheless, Newport News argues (CM 41) that its proposals were not "claims" because they were "incapable themselves of effectuating the payment of ... compensation" by the Treasury, *i.e.*, the proposals first had to be evaluated and approved by the Navy. This argument is nonsensical on its face.

50/ In a hearing before Judge Merhige, counsel for NNS stated that "when I say claim, I mean request for equitable adjustment, a term we use interchangeably."

The Treasury presumably never pays claims against it without an evaluation of their validity by some government agency, however cursory. It was reasonable to expect that the Navy would closely scrutinize the unprecedentedly large claims amounting to nearly a billion dollars contained in the Yard's several proposals for equitable adjustment. But the fact that Newport News realized that its claims would not simply be accepted at face value and immediately paid out does not alter the fact that the proposals were claims for compensation. The Supreme Court has held that even an application for a government loan is a "claim" under the Act, despite the fact that the granting of the loan is a matter for agency discretion. United States v. Neifert-White Co., supra. A fortiori, the fact that Newport News may have envisaged its claims as subject to negotiation with the Navy does not alter their status as claims. United States v. Mastros, 251 F.2d 808 (3d Cir.), cert. denied, 358 U.S. 830 (1958).

A contractor may not excuse the submission of false claims to the government on the ground that it is willing to settle for something less than the full sum it initially demands. If this were not the case, then the very purpose of the False Claims Act would be frustrated. Every contractor could escape liability for the submission of fraudulent claims to the Treasury on the ground that its claim, no matter how false, was deemed to be subject to negotiation. But this is plainly not what Congress intended, nor what the Supreme Court meant when it said that the Act prohibits "all fraudulent attempts to cause the Government to pay out sums of money." United States v. Neifert-White Co., supra, 390 U.S. at 233.

Newport News asserts (CM 40, 50) that the case law interpreting the False Claims Act has never applied the term "claim" to a proposal for equitable adjustment submitted by a defense contractor and that applying Section 287 to its proposals would expand the statute's reach "unforseeably and retroactively" in violation of the due process clause. Newport News complains (CM 50) that it has been "'lulled into the reasonable impression' that the proposals were not to be treated as 'claims'", quoting United States v. Insco, 496 F.2d 204, 209 (5th Cir. 1974).

In view of the fact that there are relatively few reported cases that address the question of what constitutes a claim within the meaning of the Act, it is not surprising that no reported case specifically deals with Newport News' contention that a proposal for equitable adjustment submitted by a defense contractor is not a "claim". This does not mean, however, that the government's application of Section 287 is novel or unforeseen. Indeed, on April 6, 1977, another major shipyard was indicted under Section 287, on the basis of a similar fraudulent proposal for equitable adjustment. United States v. Litton Systems, Inc., d/b/a Ingalls Nuclear Shipbuilding Division, Crim. No. S78-00031(R) (S.D.Miss.)51/ Litton raised almost the same

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51/ Counsel for Newport News also represent Litton Systems and thus cannot be unaware of the Litton case.

issue as Newport News raises here.[52] The district court in Virginia summarily rejected Litton's contention:

> Regardless of whether you call it a claim or an offer of settlement, or [an] equitable adjustment submission, the fact is that what is charged here is an assertion of an entitlement to money from the United States in May of 1972. That is a claim within the meaning of the statute which it is here charged was violated. That is within the statute of limitations, and, therefore the crime is not time barred.

May 20, 1977 Tr. of Hearing before Judge Albert V. Bryan, Jr. on Litton's Motion to Dismiss the Indictment, at p. 126.

It is worth noting that on appeal from Judge Bryan's dismissal of the indictment for prosecutorial misconduct, the court of appeals characterized Litton's May 1972 offer of settlement as a "claim" without discussion of the issue. United States v. Litton Systems Inc., 573 F.2d 195, 196 (4th Cir. 1978).

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[52] Litton did not even contend that its Proposal For Equitable Adjustment was not a "claim". Rather, it made the slightly more plausible argument that a letter dated May 1972, in which it offered to settle its outstanding claim (i.e., the Proposal) was not itself a claim within Section 287.

2. Newport News also contends (CM 22-26) that an indictment based upon the VCAS claim would be barred by the five year statute of limitations, 18 U.S.C. §3282. NNS reasons that because the VCAS claim was contained in the Proposal for Equitable Adjustment submitted on August 8, 1975, the statute of limitations ran out on August 7, 1980. Like Litton Systems, NNS takes the position that the statute of limitations begins to run on a Section 287 charge as soon as the elements of the offense have been committed. However, as in the Litton case, we take the position that the statute of limitations begins to run anew when and if the contractor files a subsequent amendment of its claim or a new claim.[53] Thus, in our view, NNS' letter of August 1, 1977 (contained in our appendix as Ex. #15), which informed the Navy of changes in the projected final costs of all the ships for which the Yard had submitted cost overrun claims, had the effect of starting the running of the statute of limitations anew for each of the claims. The changes in the final cost figures would, of course, have altered the amount of dollars that each claim was worth, and therefore they constituted a material amendment to the claims as originally submitted. Similarly, the offer of settlement

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[53] Indeed, at least two cases have held that the deposit or presentation for payment of a government check to which the depositor was not entitled is a false claim against the United States within the meaning of Section 287 and the civil false claims statute, 31 U.S.C. §231. United States v. Branker, 395 F.2d 881, 889 (2d Cir. 1968), cert. denied, 393 U.S. 1029 (1969); Scolnick v. United States, 331 F.2d 598 (1st Cir. 1964).

in the Litton case, filed some 18 months after the original claim had been filed, was accompanied by a downward revision of estimated final ship construction costs. The offer of settlement was held to be a "claim" within Section 287, which had the effect of extending the statute of limitations by 18 months. Judge Bryan therefore denied Litton's motion to dismiss the indictment on statute of limitations grounds. Unless Judge Bryan's decision in Litton was wrong, NNS' view of the almost identical statute of limitations question prsented here cannot prevail.

In any event, while the statute of limitations question presented by a prosecution for substantive Section 287 violations is not entirely free from doubt, Newport News has conveniently ignored the fact that we can indict the Yard and its employees for conspiracy to defraud the United States under either 18 U.S.C. §286 or §371. Because conspiracy is the classic continuing offense, an indictment under Section 286 or 371 would clearly present no statute of limitations question. Newport News does not contend otherwise, and Litton Systems, in its statute of limitations argument, conceded that had it been indicted for conspiracy rather than for a substantive violation of Section 287, there would have been no statute of limitations issue in the case.

The key count of the indictment we now contemplate will charge Newport News with a violation of 18 U.S.C. §286. It provides:

> Whoever enters into any agreement, combination or conspiracy to defraud the United States, or any department or agency thereof, by obtaining or aiding to obtain the payment or allowance of any false, fictitious or fraudulent claim, shall be fined not more than $10,000 or imprisoned not more than ten years, or both.

The beauty of Section 286 is that 1) it makes obtaining payment from the government the ultimate object of the conspiracy, rather than the mere filing of the false claims; and 2) it has a ten year penalty provision, in contrast with the five year provisions in Sections 287 and 371.

We plan to show NNS's elaborate attempts to obtain payment on its claims. This part of the conspiracy included lobbying and testifying on Capitol Hill, and efforts to blackmail the Navy by threatening, inter alia, to withdraw entirely from the Navy's nuclear shipbuilding program. In view of the fact that Newport News is one of only two shipyards capable of building nuclear ships for the Navy and the only shipyard that builds nuclear aircraft carriers, such blackmail threats had to be taken seriously by the Navy. The threats are contained in letters from the highest officials of Newport News to Navy and DoD officials. One such letter, from former NNS President J. P. Diesel to Deputy Secretary of Defense William P. Clements, is included in the appendix as Exhibit #16. This letter is but one of several in our possession of like import. We intend to pursue this aspect of the conspiracy vigorously.

Under section 286, the statute of limitations would not begin to run until at least October 5, 1978, when the Yard and the Navy agreed to a lump sum settlement of the Yard's claims. Thus, an indictment would clearly not be time barred before October 5, 1983. Indeed, insofar as Newport News continues to assert a claim of entitlement to additional vast sums of money based on the original false claims, the conspiracy is one that continues up to the present time.54/ In its Confidential Memorandum, Newport News brazenly asserts two legal theories under which it is entitled to seek additional compensation from the Navy. First, NNS argues (CM 143-155) that it is entitled to rescind the settlement it reached with the Navy and seek full compensation for all of its cost overrun claims because, by instituting this criminal investigation, the Navy has allegedly breached "an implied contractual duty to take no action which will impede the enjoyment by the Company of the benefits of the settlement agreement" (CM 152). The Yard contends (CM 156-169) in the alternative that it is entitled to additional sums of money for the 21 claim items that were, unbeknownst to it, "excluded" from the settlement by the Navy because they were

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54/ Assuming that counsel for Newport News are aware of the false character of the claims, they would be subject to prosecution as co-conspirators under Section 286, and very likely under Section 287 as well.

regarded as probably fraudulent.55/ We have requested the Civil Division of Main Justice to evaluate the merits of these two contractual arguments. For present purposes, it is sufficient to point out that in the very same Confidential Memorandum in which ITNS initially argues that a prosecution is time barred, it actually concludes by reasserting all of its original false claims, thereby extending the Section 286 conspiracy until the present time. By the same token, the Confidential Memorandum may also have the effect of either extending the statute of limitations on the original claims for purposes of a prosecution under Section 287, or may itself constitute the filing of a new group of false claims against the United States.

55/ We do not yet understand why the Navy chose to exclude only those 21 claim items from the settlement, since the Navy CITARS indicate that some degree of fraud was involved in the majority of the 260-odd claim items.

VII. CONCLUSION AND RECOMMENDATIONS

1. It is clear beyond cavil that the individual claims analyzed above are not only false and without legal merit, but that their preparation was purposeful and criminal.

Moreover, when the individual claims are evaluated against [redacted] a broadly based conspiracy, and against each other as well, it is apparent that NNS approached the claims effort with the singleminded purpose of inflating the claims to the greatest extent possible. The inference is inescapable that NNS' plan was to make the claims huge enough to choke the Navy's normal procedural mechanism for their orderly review. The claims could then be settled en bloc, through horse-trading -- a process that would allow the Yard to collect millions of dollars on claims that had no merit. This in fact happened.

The conspiracy we have uncovered is staggering in its size and complexity. NNS' claims effort was perhaps the largest assault on the Treasury in American history. Because of the sheer size and complexity of its claims, and because the government lacked the immense resources required to litigate each claim in court, NNS' scheme succeeded. The Navy settled the claims for $208 million. The evil inherent in the conspiracy to defraud the government was exacerbated by NNS' use of extortion tactics to pressure the Navy into agreeing to a settlement of its claims. In essence the Yard held the Navy's nuclear shipbuilding program, and hence the national defense, hostage until the Navy agreed to a favorable settlement of its claims. This successful effort to defraud the United States warrants the best effort the government can muster to bring the Yard and its employees to the bar of justice.

Statute of limitations considerations make it advisable that the investigation be concluded by late spring or early summer 1982. Otherwise, we may not be able to bring substantive 287 counts. Obviously, because of the sheer number of claims and the short time remaining, most of the claim items cannot be investigated at all, much less with the thoroughness given the VCAS claim. However, we can pursue the several claims discussed in this memo within the time remaining, as well as [redacted] provided that the present investigative team is not sidetracked with other case assignments. Of course, we do not want to return an indictment on one claim item alone. Several individual claims must be included to show a pattern, to dispel any argument of mistake, and to demonstrate the existence of the overall conspiracy.

Much the time lost in the investigation to date must be attributed to lawyers playing "musical chairs" and to an overly compartmentalized approach to the case by the several attorneys who earlier participated in the investigation. Almost as soon as a Main Justice attorney got deeply involved in the investigation he or she would disappear to work on other cases. In addition, the Justice attorneys relied too heavily on the Navy attorneys to conduct detailed grand jury investigation which they later failed to assimilate. The Navy attorneys were often lost in the field of criminal law and frequently appeared to receive little or no guidance from the Justice Department attorneys.

The Navy attorneys were reluctant to express their bottom line views on various claims, and on the occasions when they did so their views were often disregarded, as in the preparation of the initial pros memo. This lack of continuity of counsel was noted by Judge Merhige on April 22, 1981, when he ruled against NNS' motions to quash the enforcement of existing subpoenas, and to terminate the grand jury investigation [redacted]

2. In addition to continuity of assignments, we need paralegal assistance to digest the grand jury testimony and organize and assemble documentary evidence. [redacted] The United States Attorney's Office for the Eastern District of Virginia can provide one paralegal; we request one additional paralegal assistant from the Department.

Respectfully submitted,

Joseph A. Fisher, III
Chief, Fraud Section
Eastern District of Virginia

Joseph J. Aronica
Assistant United States Attorney
Eastern District of Virginia

David B. Smith
Attorney, Appellate Section
Criminal Division
Department of Justice

EXHIBIT V

NOVEMBER 1981 -- FISHER-ARONICA STATUS REPORT APPENDIX

U.S. Department of Justice

U.S. Attorney
Eastern District of Virginia

→ Redacted

Status Report Re: Investigation of Newport News Shipbuilding Claims for Equitable Adjustment

Appendix

[illegible]

EXHIBITS

1. VCAS claim draft, unknown author.

2a. VCAS claim draft prepared by Doyle from claim draft Ex. #3.

2b. Typed copy of VCAS claim draft Ex. #2a.

3. VCAS claim draft prepared by L. Mangus.

4. VCAS claim draft prepared by L. Mangus.

5. Final VCAS claim draft submitted to the Navy on August 8, 1975 by NNS in its Proposal for Equitable Adjustment on the DLGN 38-40 cruisers.

6. Draft of a change order request on the VCAS, dated June 4, 1975. It was never filed.

7. Doyle's draft of the VCAS claim as marked up in red pen by an NNS cost estimator, C. Wesley. Attached thereto is a separate handwritten chronology written by C. Wesley. Also attached is a buckslip dated June 16, 1975, showing that a copy of this annotated draft was handed to E. Alexander of Contract Controls, team leader for the cruisers, on June 16, 1975.

8. VCAS claim draft, Ex. #2b with handwritten comments by an NNS cost estimator in the upper right hand corner.

[redacted]

10. DAR §3-404.4

11. Wesley-Krause memorandum dated April 18, 1975.

12. Graphic illustration of the fixed-price incentive contract.

13. VCAS contract specifications for the DLGN 38-40 cruisers.

14. The Navy's Claim Item Technical Analysis Report (CITAR) on the [illegible] ventilation control air system (VCAS) [illegible] the [illegible]

15. Letter dated August 1, 1977, from C. L. Willis to the Supervisor of Shipbuilding Conversion and Repair, U.S. Navy updating final costs on NNS' several proposals for equitable adjustment, including Contract N000-70-C0252 (DLGN 38-40).

16. Letter dated June 14, 1976, from NNS President J. P. Diesel to Deputy Secretary of Defense William P. Clements.

[redacted]

#1

AX 206-6 DLGN 36 – 6 Section

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of material during efforts to fit the sheet polyethylene to curved surfaces under conditions that precluded efficient work. The actual wastage was astronomical in comparison to that which occurs during polyethylene installation under better conditions. [illegible]

Since the Government created this problem by indicating that cast-in-place polyethylene would be used, whereas the Contractor was forced to install sheet polyethylene to suit the reactor plant lead yard design, and since the Contractor could not possibly have perceived the ultimate scope of work required from the original bidding plans, the Contractor is fully entitled to compensation and requests that the contract price be adjusted equitably to include the cost of added work.

5.1.1.12 Control Air System. No estimate!

Previously discussed problems arising in the reactor plant lead yard and Contractor interface resulted from untimely receipt of drawings or inadequate design or fabrication. Contractor costs due to the control air system were created not only by the same problems, but also by an inadequate contract guidance drawing. Contract guidance drawings are issued by the Government prior to bidding to allow prospective contractors to estimate costs and formulate bids. In most cases, a Contractor who has performed similar work under previous contracts with the Government will accept an inadequate contract guidance drawing and will for-

[redacted]

Hence, because of the vagueness of the contract drawing and the absence of any working drawings, the Contractor, in good faith, based his bid on the system employed in the DLGN35 Class.

Contract vs contract guidance dwg

[illegible]

AX.205-6 [illegible]

6

As the design evolved, it became apparent that the control air syst for DLGN38 was significantly more complex and would require more material than the system employed on the previous ships. Construction and testing of the sys also required significantly more manhours than it was possible to perceive previously.

As of January 1, 1975, the Contractor has not received the complete set of workable drawings for this system from the Government's reactor plant lea yard. A preliminary request for additional funding based on the increased complexity of the system was rejected by SupShip-NN on the grounds that the contrac guidance drawings contained sufficient information to permit formulation of an accurate bid. If readjustment has not been obtained by the time the system is completed and tested, the ventilation control air system will constitute a justifiable claim subject with the claim also possibly containing delay and disruption costs. Until such time, the Contractor reserves all rights to equitable adjustment for his added work on this system.

[redacted]

#2A

Volume 2
Section 5

5.2.8 Control Air System

~~Previously discussed problems arising in the reactor plant lead yard~~ and Contractor ~~interface resulted from untimely receipt of drawings or inadequate design or fabrication. Contractor costs due to the control air system were occasioned only by these same problems, [illegible]~~ an inadequate ~~[illegible]~~ Government plan [illegible] ~~[illegible]~~) and ~~[illegible]~~ [illegible] in Section 9890-1 of the Specifications for Building Nuclear Powered Guided Missile Frigate DLGN38. (cause) the Contractor to [illegible]

Section 9890-1 a PROPULSION: NUCLEAR POWER, General previously states that reactor plant services to those provided in the DLGN 36 Class will be installed in the DLGN 38 Class. The same specification section, 9890, provides that reactor plant ventilation system fans, filters, heaters and instruments shall be in accordance with the contract guidance plan DLGN 35 - 530 - 4355731, however this plan was unavailable and was not provided to the Contractor by the Government. The Contractor was without unable, or in any case failed, to determine from the documents that the DLGN 35 reactor plant ventilation system was to be considered a nuclear system and not a non nuclear system as were the case with the DLGN 35 Class. Neither was the Contractor in a position to quantify any difference ~~which~~ could [illegible]:

.. In that basis, therefore, the contractor assumed that the contract design for the DLGN 38 class ventilation system would be similar to that on the DLGN 36 class and executed its contract accordingly.

Contract ~~diagrams are issued by the Government for guidance prior~~ to ~~bidding to allow prospective contractors to estimate costs and formulate bids. In most cases, a contractor who has [illegible] similar work under previous contracts with the Government will accept an inadequate contract diagram and will formulate [illegible] on the basis of the similar work performed previously.~~

In the case of the DLGN 38 ventilation system, [illegible] The design of this system ~~was~~ still evolving at the time bids were being prepared ~~and~~ but continued long after finalization of the contract. As the design developed, it became apparent that the control air system for DLGN38 was significantly more complex and would require more material and manhours than the system employed on the previous ships. This was first illustrated ~~[illegible]~~ in July, 1973, when the system diagram, # [illegible] was [illegible] (The material changes on this diagram subsequently resulted in receipt of HCR 145 which corrected a portion of the component and fitting requirements). After receipt of the ~~system~~ control air working drawings which became available on November 21, 1974 (Forward Plant) and October 1, 1974 (Aft Plant), it became evident that ~~a serious discrepancy existed between~~ the original estimate for the reactor compartment ventilation control air system was greatly underestimated ~~and the actual requirements for material and labor. Since the working drawings were not available at the time of the original estimate, and due to the wording~~

~~in the applicable section of the shipbuilding specifications, the original estimate was developed from the misleading implication that this system would be basically the same as that on DLGN36 and therefore the contract diagram would be acceptable for use in preparation of this estimate as a non-nuclear system.~~ → From the review of these plans, the data contained therein were so insufficient as to preclude meaningful analysis

major ~~The basic~~ significant problem in making the original estimate from the contract diagram and preparation of HCR 145 estimate from the system diagram was the inability of the estimators to determine the length of piping required in the ventilation control air system. This data ~~is~~ are required to calculate the material requirements which in turn forms the basis for the manhour estimate. Consequently, the original system estimate and HCR 145 estimate do not include the required material and manhour requirements necessary for construction of this system.

The second element that contributed to this deficiency was the oversight of the Contractor's personnel to recognize that this system had changed from non-nuclear on DLGN36 to nuclear on DLGN38 with all the attendant inspection and certification requirements for which no manhours have been allotted. This oversight is attributed to the misleading words in the shipbuilding specifications.

The third factor that seriously affected the system estimate was the assumption made by the Contractor's Cost Engineering and Design Engineering personnel that the system test fitting and manhour requirements had not increased significantly since the system was thought to be non-nuclear and similar to that on DLGN36. This problem was identified to the Government, by letter 601/1-13-601-2631-DRPD 2681/15 dated November 19, 1974, as an increase in scope of the DLGN38 Acceptance Test Program. The response to this problem from the Government was received on December 11, 1974, in their letter

08-9080-SER 08J-8411 dated December 10, 1974, which stated their opinion that we had adequate information in the contract guidance drawing available to foresee these requirements. This statement was made even though the Government was aware that no test procedures were available to the Contractor at the time of bid preparation. Had these test procedures, or system working drawings or appropriate wording in the shipbuilding specifications noting that the system requirements were extensively increased, been available to the Contractor at the time of bid preparation, a completely different system with all of its ramifications would have been revealed. Hence, because of the vagueness of the contract diagram and the absence of any working drawings, test procedures and appropriate wording in the shipbuilding specifications, the Contractor in good faith based his bid on the system employed in the DLGN36 class. There should be no question as to whether it was furnished in the Government under the Contractor. The [illegible] of the Contractor's estimate [illegible] [illegible] [illegible] Based on these facts, it is apparent that adequate information was not available to estimate properly the construction costs for the reactor compartment ventilation control air system. [illegible] the Government [illegible] who reviewed the contractor's [illegible]

In addition to the estimate discrepancy, a significant number of design development problems have come up that have increased costs and are presented as follows:

1. The diagram for the reactor compartment ventilation control air system (NN Dwg. 9572-19) requires the pressure switch and transmitter components to meet the submersibility operational requirements. Since the Contractor was unable to purchase components that would meet this criteria, it was decided to relocate these components outside of the core removal compartment in the passageway. Subsequently, the Government design personnel decided that relocating these components did not satisfy the submersibility requirements and therefore would require a water

tight enclosure. The water tight enclosures are presently being developed from a Reactor Plant Lead Yard sketch (DLGN38-P-287). This added work is a direct result of meeting design criteria of an impractical nature as illustrated by a non-existent source of components that would meet the submersibility operational requirements.

2. Three Plan Revision Notices (PRNs) have been received and incorporated to include missing information and to resolve a major foul. Specifically, PRN-A-747 (#2 plant) was issued to clear a major foul with the charging system. This necessitated significant rework of the Contractor's drawing 9572-21, and added material requirements. PRN-A-743 (#2 plant) and PRN-A-742 (#1 plant) added missing information to the control air system drawings, 9572-21 and 9572-20. Had this information been available earlier, a significant amount of disruption due to drawing revision would not have occurred.

3. A major longstanding problem that is causing delay and disruption is in obtaining legible sepia prints from the Reactor Plant Lead Yard which is necessary to ensure proper construction of the reactor plant ventilation control air system.

As of January 1, 1975, the Contractor has not received the complete set of working drawings for this system from the Government's reactor plant lead yard. A second preliminary request for additional funding is being prepared for submittal to the Government as a response to the Change Order based on the increased complexity of the system and lack of adequate Government furnished information to ~~permit [illegible] of an accurate bid. If [illegible] has not been obtained by the time the system is completed and tested, the ventilation control air system will constitute a~~

justifiable claim with the claim also possibly containing delay and disruption costs. If a contract change order is received for this system, then the price estimate for this work will be excluded from the claim. In any event, the Contractor reserves all rights to equitable adjustment in the areas of delay and disruption that may result from problems associated with this system.

Memorandum
NN FORM 1-2 (REV. 1)

DATE 6/6/75

TO: Mr. A. J. Thomas, Jr.

FROM: Claims Group

SUBJECT: 601 Proposal, Section 5.2.8 - Control Air Syste

Please review and comment on the attache Control air System write-up. Your comments are requested ASAP to enable us to discuss this section with contracts.

01194

06961.

PUT IT IN WRITING
AVOID MISTAKES

Jurl
6/5/75

5.2.8 Control Air System

An inadequate Government plan, contract guidance plan DLGN38-800-4385731, and ambiguity in Section 9890-1 of the Specifications for Building Nuclear Powered Guided Missile Frigate DLGN38 caused the Contractor to incur costs not contemplated at the time of contract execution. Section 9890-1a, PROPULSION: NUCLEAR POWER, General, provides that two reactor plants similar to those provided in the DLGN36 Class will be installed in the DLGN38 Class. This same specification section, 9890, provides that reactor plant ventilation system fans, filters, valves, and instruments shall be in accordance with contract guidance plan DLGN38-800-4385731; however, this plan was unavailable to the Contractor prior to definitization of the contract. The Contractor was therefore unable, or in any case failed, to determine from these documents that the DLGN38 reactor plant ventilation system was to be considered a nuclear system and not a non-nuclear system as was the case with the DLGN38 Class. Neither was the Contractor in a position to quantify any differences which could be reflected on the unavailable contract guidance plan. On that basis, therefore, the Contractor assumed that the contract design for the DLGN38 Class ventilation system would be similar to that on the DLGN36 Class and executed the contract accordingly.

In the case of the DLGN38 ventilation system, not only was the design of this system still evolving at the time bids were being prepared, but continued long after finalization of the contract. As the design developed, it became apparent that the control air system for DLGN38 was significantly more complex and would require more material and manhours than the system employed on the previous ships. This was first illustrated in July 1973, when the system diagram, No. 9572-19 was received. (The material changes on this diagram subsequently resulted in receipt of [illegible] 145 which corrected a portion of the

component and fitting requirements.) After receipt of the control air piping working drawings which became available on November 21, 1974 (Forward Plant) and October 1, 1974 (Aft Plant), it became evident that the original estimate for the reactor compartment ventilation control air system was greatly understated.

Even after receipt of these plans, the data contained therein were so deficient as to preclude meaningful analysis. One significant problem in making the original estimate from the contract diagram and preparation of HCR 145 estimate from the system diagram was the inability of the estimators to determine the length of piping required in the ventilation control air system. These data are required to calculate the material requirements which in turn forms the basis for the manhour estimate. Consequently, the original system estimate and HCR 145 estimate do not include the required material and manhour requirements necessary for construction of this system.

The second element that contributed to this deficiency was the oversight of the Contractor's personnel to recognize that this system had changed from non-nuclear on DLGN36 to nuclear on DLGN38 with all the attendant inspection and certification requirements for which no manhours have been allotted. This oversight is attributed to the misleading words in the shipbuilding specifications.

The third factor that seriously affected the system estimate was the assumption made by the Contractor's Cost Engineering and Design Engineering personnel that the system test fitting and manhour requirements had not increased significantly since the system was thought to be non-nuclear and similar to that on DLGN36. This problem was identified to the Government, by letter 601/1-13-601-2681-DRPD 2681/15 dated November 19, 1974, as an increase in scope of the DLGN38 Acceptance Test Program. The response to this

problem from the Government was received on December 11, 1974, in their letter OS-SC80-SER 03J-8411 dated December 10, 1974, which stated their opinion that we had adequate information in the contract guidance drawing available to foresee these requirements. This statement was made even though the Government was aware that no test procedures were available to the Contractor at the time of bid preparation. Had these test procedures, or system working drawings or appropriate wording in the shipbuilding specifications noting that the system requirements were extensively increased, been available to the Contractor at the time of bid preparation, a completely different system with all of its ramifications would have been revealed. Hence, because of the vagueness of the contract diagram and the absence of any working drawings, test procedures and appropriate wording in the shipbuilding specifications, the Contractor in good faith based his bid on the system employed in the DLGN36 Class. There should be no question as to whether the data furnished by the Government misled the Contractor. The detail of the Contractor's estimate clearly reveals that he was misled. That the data itself was deficient is supported by the fact that it also misled the Government personnel who reviewed the Contractor's estimate. Based on these facts, it is apparent that adequate information was not available to estimate properly the construction costs for the reactor compartment ventilation control air system.

In addition to the estimate discrepancy, a significant number of design development problems have come up that have increased costs and are presented as follows:

1. The diagram for the reactor compartment ventilation control air system (NN Drawing 9572-19) requires the pressure switch and transmitter components to meet the submersibility operational requirements. Since the Contractor was unable to

purchase components that would meet this criteria, it was decided to relocate these components outside of the core removal compartment in the passageway. Subsequently, the Government design personnel decided that relocating these components did not satisfy the submersibility requirements and therefore would require a water tight enclosure. The water tight enclosures are presently being developed from a Reactor Plant Lead Yard sketch (DLGN38-P-287). This added work is a direct result of meeting design criteria of an impractical nature as illustrated by a non-existent source of components that would meet the submersibility operational requirements.

2. Three Plan Revision Notices (PRNs) have been received and incorporated to include missing information and to resolve a major foul. Specifically, PRN-A-747 (#2 plant) was issued to clear a major foul with the charging system. This necessitated significant rework of the Contractor's drawing 9572-21, and added material requirements. PRN-A-743 (#2 plant) and PRN-A-742 (#1 plant) added missing information to the control air system drawings, 9572-21 and 9572-20. Had this information been available earlier, a significant amount of disruption due to drawing revision would not have occurred.

3. A major longstanding problem that is causing delay and disruption is in obtaining legible sepia prints from the Reactor Plant Lead Yard which is necessary to ensure proper construction of the reactor plant ventilation control air system.

As of January 1, 1975, the Contractor has not received the complete set of working drawings for this system from the Government's reactor plant

lead yard. A second preliminary request for additional funding is being prepared for submittal to the Government as in response to a Change Order based on the increased complexity of the system and lack of adequate Government furnished information. If a contract change order is received for this system, then the price estimate for this work will be excluded from this proposal. In any event, the Contractor reserves all rights to equitable adjustment in the areas of delay and disruption that may result from problems associated with this system.

#3

5.2.8 Control Air System

Previously discussed problems arising in the reactor plant lead yard and Contractor interface resulted from untimely receipt of drawings or inadequate design or fabrication. Contractor costs due to the control air system were created not only by these same problems, but also by an inadequate contract diagram (4335731) and misleading words in Section 9890-1 of the Specifications for Building Nuclear Powered Guided Missile Frigate DLGN38. This section of the specifications implies that the ventilation system will be similar to that provided on the DLGN36 Class and shall be in accordance with the working drawings.

Contract diagrams are issued by the Government for guidance prior to bidding to allow prospective contractors to estimate costs and formulate bids. In most cases, a contractor who has performed similar work under previous contracts with the Government will accept an inadequate contract diagram and will formulate his estimates on the basis of the similar work performed previously. The design of this system was still evolving at the time bids were being prepared and continued long after finalization of the contract. As the design developed, it became apparent that the control air system for DLGN38 was significantly more complex and would require more material and manhours than the system employed on the previous ships. This was first illustrated when the system diagram was received in July, 1973. The material changes on this diagram subsequently resulted in receipt of EMR 145 which corrected a portion of the component and fitting requirements. After receipt of the system working drawings which became availabla on November 21, 1974 (Forward Plant) and October 1, 1974 (Aft Plant), it became evident that a serious discrepancy existed between the original estimate for the reactor compartment ventilation control air system and the actual requirements for material and labor. Since the working drawings were not available at the time of the original estimate, and due to the wording in the applicable section of the detailed building specifications, the original estimate was developed from the misleading implication that this system would be basically the same as that on DLGN36 and therefore the contract diagram would be acceptable to use in preparation of this estimate as a non-nuclear system.

The first significant problem in making the original estimate from the contract diagram and preparation of ECR 145 estimate from the system diagram was the inability of the estimators to determine the length of piping required in the ventilation control air system. This data is required to calculate the material requirements which in turn forms the basis for the manhour estimate. Consequently, the original system estimate and ECR 145 estimate do not include the required material and manhour requirements necessary for construction of this system.

The second element that contributed to this deficiency was the oversight of the Contractor's personnel to recognize that this system had changed from non-nuclear on DLGN36 to nuclear on DLGN38 with all the attendant inspection and certification requirements for which no manhours have been allotted. This oversight is attributed to the misleading words in the shipbuilding specifications.

The third factor that seriously affected the system estimate was the assumption made by the Contractor's Cost Engineering and Design Engineering personnel that the system test fitting and manhour requirements had not increased significantly since the system was thought to be non-nuclear and similar to that on DLGN36. This problem was identified to the Government, by letter 601/1-13-601-2681-DRPD 2681/15 dated November 19, 1974, as an increase in scope of the DLGN38 Acceptance Test Program. The response to this problem from the Government was received on December 11, 1974, in their letter

08-9050-SER 03J-8411 dated December 10, 1974, which stated that we had adequate information in the contract guidance drawing available to foresee these requirements. This statement was made even though the Government was aware that no test procedures were available to the Contractor at the time of bid preparation. Had these test procedures, or system working drawings or appropriate wording in the shipbuilding specifications noting that the system requirements were extensively increased, been available to the Contractor at the time of bid preparation, a completely different system with all of its ramifications would have been revealed. Hence, because of the vagueness of the contract diagram and the absence of any working drawings, test procedures and appropriate wording in the shipbuilding specifications, the Contractor in good faith based his bid on the system employed in the DLGN36 class.

Based on these facts, it is apparent that adequate information was not available to estimate properly the construction costs for the reactor compartment ventilation control air system.

In addition to the estimate discrepancy, a significant number of design development problems have come up that have increased costs and are presented as follows:

1. The diagram for the reactor compartment ventilation control air system (NN Dwg. 9572-19) requires the pressure switch and transmit components to meet the submersibility operational requirements. Since the Contractor was unable to purchase components that would meet this criteria, it was decided to relocate these components outside of the core removal compartment in the passageway. Subsequently, the Government design personnel decided that relocating these components did not satisfy the submersibility requirements and therefore would require a water

tight enclosure. The water tight enclosures are presently being developed from a Reactor Plant Lead Yard sketch (DLCN38-P-287). This added work is a direct result of meeting design criteria of an impractical nature as illustrated by a non-existent source of components that would meet the submersibility operational requirements.

2. Three Plan Revision Notices (PRNs) have been received and incorporated to include missing information and to resolve a major foul. Specifically PRN-A-747 (#2 plant) was issued to clear a major foul with the charging system. This necessitated significant rework of the Contractor's drawing 9572-21, and added material requirements. PRN-A-743 (#2 plant) and PRN-A-742 (#1 plant) added missing information to the control air system drawings, 9572-21 and 9572-20. Had this information been available earlier, a significant amount of disruption due to drawing revision would not have occurred.

3. A major longstanding problem that is causing delay and disruption is in obtaining legible sepia prints from the Reactor Plant Lead Yard which is necessary to ensure proper construction of the reactor plant ventilation control air system.

As of January 1, 1975, the Contractor has not received the complete set of working drawings for this system from the Government's reactor plant lead yard. A second preliminary request for additional funding is being prepared for submittal to the Government based on the increased complexity of the system and lack of adequate Government furnished information to permit formulation of an accurate bid. If readjustment has not been obtained by the time the system is completed and tested, the ventilation control air system will constitute a justifiable claim with the claim also possibly containing delay and disruption costs. If a contract change order is received for this system, then the price estimate for this work will be excluded from the claim. In any event, the Contractor reserves all rights to equitable adjustment in the areas of delay and disruption that may result from problems associated with this system.

CARL W. [illegible]

NN-1497

DLGN 38, 39 & 40
REVIEW DRAFT
7-6-75
082 COMMENTS
32 of 33

#4

5.2.8 Control Air System

The control air system for the DLGN38 Class ships, which serves the reactor compartment ventilation isolation and diverting valves, is an extensively redesigned and enlarged system built to nuclear standards based on Contract Guidance Plan DLGN38-800-4385731. This contrasts with the DLGN36 Class ships on which the control air system is a small system serving only the reactor compartment ventilation diverting valves. It was designed as a non-nuclear system on the DLGN Class from drawings developed by the Contractor based on the control air system shown in phantom on the reactor compartment ventilation system contract guidance plan for the control air system.

Two significant problems existed at the time the bid proposal was prepared for the DLGN38 Class ships. The first problem was that the Contractor did not realize that this system had changed from non-nuclear to nuclear. The second problem was that for some inexplicable reason the Contractor's new ship estimating department failed to estimate the majority of this system since the areas of responsibility were not clearly defined, due to its increased size. — ?

Apparently each of the Contractor's estimating sections thought another section was estimating this system. Consequently, the bid submitted for the DLGN38 Class ships' control air system contained an estimate for the high pressure air portion of the control air system only, and this estimate was prepared on the basis that the system would be non-nuclear. This estimate obviously contains only a small fraction of the actual cost of the control air system being installed on the DLGN38 Class ships.

GOVERNMENT EXHIBIT 11

It is the contention of the Contractor that removing the design development responsibility of this system from the Contractor and placing it with an outside [illegible] communications link between the Contractor's [illegible] thereby [illegible] contributed significantly to the extreme disparity in the control air system estimate. This action by the Government is considered unusual since the Contractor had developed the DLGN36 Class control air system and, in fact, subsequently developed a significant portion of the DLGN38 Class control air system. In conjunction with this, the wording contained in the Detail Specifications may have contributed to the underestimate of the control air system in that Section 9890-1-a states: "Two reactor plants similar to those provided in the DLGN36 Class shall be installed in accordance with . . ." It is quite conceivable that these words could have misled the estimator into thinking this system would be non-nuclear as was the case on DLGN36/37.

As the DLGN38 Class control air system design developed, it became apparent that the system was significantly more complex and would require more material and manhours to construct than the system employed on previous ships. This became evident in July 1973, when the diagram for the ventilation control air system (Electric Boat Drawing No. 38643-01X01) was received. This diagram added material components, not shown on the contract guidance plan, to the system for which the Contractor negotiated additional money and manhours in Headquarters Modification Requisition 145. This contract modification did not in any way diminish the disparity in the original system estimate.

After receipt of the control air piping working drawings which became available on October 1, 1974 (aft plant) and November 21, 1974 (forward plant) the [illegible] ventilation [illegible] significantly exceeded any [illegible] of [illegible] to that of the [illegible] Class. In view of this, and based on the [illegible] misconception that this system was non-nuclear, it was realized that no provisions had been made for the testing requirements associated with this system. The problem was identified to the Government, by letter 601/1-13, 601-2681, DRPD 2681/15, dated November 19, 1974, as an increase in scope of the DLGN38 Class acceptance test program. The response to this problem by the Government was received on December 11, 1974, in their letter 08-9000, Ser 08J-8411, dated December 10, 1974, which stated their opinion that we had available adequate information in the contract guidance drawing to foresee these requirements. This statement was made even though the Government was aware that no effort had been made on their part to properly inform the Contractor of the drastic changes in the control air system. Had the Government made some additional effort to do this, quite conceivably, an entirely adequate bid estimate would have been prepared.

In addition to the estimate discrepancy, a significant number of design development problems have come up which have increased costs and are presented as follows:

1. The diagram for the reactor compartment ventilation control air system (Electric Boat Drawing No. 38643-01X01) requires the pressure switch and transmitter components to meet the submersibility operational requirements. Since the Contractor was unable to purchase components that would meet this criteria, it was decided to relocate these components outside of the core removal compartment in the passageway. Subsequently, the Government design personnel decided that relocating these components did not satisfy the submersibility requirements and [illegible] therefore, requiring [illegible] watertight enclosure. [illegible] components are presently [illegible] from a Reactor Plant Lead Yard sketch (DLGN[illegible]-P-237). This added work is a direct result of attempting to meet design criteria of an impractical nature as illustrated by a non-existent source of

components which would meet the submersibility operational requirements.

2. Three Plan Revision Notices (PRNs) have been received and incorporated to include missing information and to resolve a major foul. Specifically, PRN-A-747 (#2 plant) was issued to clear a major foul with the Coolant Charging System. This necessitated significant rework of the Contractor's drawing 9572-21 and added material requirements. PRN-A-743 (#2 plant) and PRN-A-742 (#1 plant) added missing information to the control air system drawings, 9572-21 and 9572-20. Had this information been available earlier, a significant amount of disruption due to drawing revision would not have occurred.
3. A major longstanding problem that is causing delay and disruption is in obtaining legible sepia prints from the Reactor Plant Lead Yard which are necessary to ensure proper construction of the reactor plant ventilation control air system.

As of January 1, 1975, the Contractor has not received the complete set of working drawings for this system from the Government's Reactor Plant Lead Yard. A second preliminary request for additional funding is being prepared for submittal to the Government as in response to a Change Order [redacted] lack of adequate Government [redacted] then [redacted] In any event, the Contractor reserves all rights to equitable adjustment in the areas of delay and disruption that may result from problems associated with this system.

The fact is that essentially no available evidence exists, other than that contained in the specifications for building DLGN38 Class ships, which indicates the Government made any effort at all to properly notify and inform the Contractor that this system had grown immensely in size, inspection criteria and test requirements. It is the contention of the Contractor that a mutual mistake has been made relative to this system and that, at the very least, equitable adjustment to cover the Contractor's cost of constructing this system should be made.

Weak case!

2/2/73.

5.2.3 Control Air System

Section 9590-1a, PROPULSION: NUCLEAR POWER, General, of the specifications, provides that two reactor plants similar to those provided in the DLGN36 Class will be installed in the DLGN38 Class. As the opening statement in the specification section governing nuclear power, the Contractor had the right to assume, and did assume, that the reactor plant design for the DLGN38 Class would be similar to that employed in the DLGN36 Class. This same specification section, 9590, provided that reactor plant ventilation system fans, filters, valves, and instruments shall be in accordance with Government furnished Contract Guidance Plan DLGN38-800-4375731. Although this plan was available to the Contractor at the time of definitization of the contract by Contract Modification P00007, with an effective date of December 21, 1971, it could not then be recognized that it was so vague and misleading as to be deficient for either proposal or performance purposes. Specifically, with the exception of the high pressure (HP) air system, these documents did not reveal the extent of any changes in the design of the DLGN38 reactor plant ventilationcontrol air system; and as a result, the contract was definitized with only the changes in the high pressure air portion included in the Contractor's pricing. The balance of the control air system was considered to be similar to that incorporated into the DLGN36 Class ships; that is, it was considered that the control air system would be a small non-nuclear system serving the reactor compartment ventilation valves and not an extensive and enlarged nuclear system serving the reactor compartment isolation and diverting valves.

The design of this system kept evolving after the contract was definitized by Modification P00007, effective December 21, 1971, and continued to evolve long after definitization of the contract. As the design proceeded in its development, it became apperent that the control air system for DLGN38 was significantly more complex and would require more material and manhours than the system employed on the previous ships. The first meaningful indication of the extent of the change became evident in July, 1973, when the diagram for the ventilation control air system (Electric Boat Plan No. 38643-01X01) was received. This plan was furnished to the Contractor as provided by Section 9890-1-b of the specifications which specify that the Government furnished working plans will be based on the contract and contract guidance plans. (The material changes on this ventilation control air system diagram subsequently resulted in issuance of ECR 145, incorporated in the contract by Modification A00468, dated November 13, 1974, which corrected a portion of the component and fitting requirements.) Further indication that the system obviously had become much more complex than could have been reasonably anticipated became visible after receipt of the Government furnished control air piping working plans which became available on November 21, 1974 (Forward Plant) and October 1, 1974 (Aft Plant). These Government furnished plans revealed that the reactor compartment ventilation control air system had been designed to a degree of complexity which, rather than being similar, greatly exceeded the DLGN36 Class design.

Even after receipt of these plans, the full extent of the changes in the design requirements were unclear. The data contained therein were so incomplete and ambiguous as to preclude meaningful analysis. One continued problem in preparing the original estimate from the contract diagram and in preparing the ECR 145 estimate from the system diagram was the lack of data necessary to determine the length of piping required in the ventilation control air system. These data are required to calculate the material requirements and in turn form the basis for the manhour estimate. Consequently, as the result of the continuing deficient nature of the Government furnished design data, the original system estimate and the ECR 145 estimate did not include the required material and manhour requirements necessary for the construction of this system as it was finally designed.

Another factor that seriously affected the complexity was that system test fitting and manhour requirements had increased significantly over the non-nuclear system in the DLGN36 Class. This problem was identified to NAVSEA by letter 601/1-13, 601-2681, DRPD 2681/15, dated November 19, 1974, as an increase in scope of the DLGN38 Acceptance Test Program. The response from NAVSEA to this problem was received on December 11, 1974, in their letter 08-9080, Ser 08J-8411, dated December 10, 1974, which stated an opinion that the Contractor had had adequate information in the contract guidance drawing available to foresee these requirements. This statement was made even though the Government was aware that no test procedures were available to the Contractor at the time the contract was definitized by Modification P00007 on December 21, 1971. Had these test procedures, or system working drawings, or appropriate wording in the shipbuilding specifications noting that the system requirements were extensively increased been available to the Contractor, a completely different system with all of its ramifications would have been revealed. Hence, because of the vagueness of the contract diagram and the absence of any working drawings, test procedures, and appropriate wording in the shipbuilding specifications, the Contractor in good faith could only assume that the system would be similar to the system employed in the DLGN36 Class. There should be no question as to whether the data furnished by the Government was inadequate to the Contractor.

In addition to the basic design discrepancy discussed above, a significant number of problems have been encountered in the control air working plans furnished by the Government. Correction of these Government furnished non-deviation working plans resulted in added work by the Contractor which was not contemplated at the time the contract was definitized. These problems include:

1. The diagram for the reactor compartment ventilation control air system (NN Drawing 9572-19) requires the pressure switch and transmitter components to meet the submersibility operational requirements. Since the Contractor was unable to

purchase components that would meet this criteria, it was necessary to relocate these components outside of the core removal compartment in the passageway. Subsequently, the Government design personnel decided that relocating these components did not satisfy the submersibility requirements and therefore would require a water tight enclosure. The water tight enclosures are presently being developed from a Reactor Plant Lead Yard sketch (DLGN38-P-287). This added work is a direct result of meeting design criteria of an impractical nature as illustrated by a non-existent source of components that would meet the submersibility operational requirements.

2. Three Plan Revision Notices (PRNs) have been received and incorporated to include missing information and to resolve a major foul. Specifically, PRN-A-747 (#2 plant) was issued to clear a major foul with the charging system. This necessitated significant rework of the Contractor's drawing 9572-21, and added material requirements. PRN-A-743 (#2 plant) and PRN-A-742 (#1 plant) added missing information to the control air system drawings, 9572-21 and 9572-20. Had this information been available earlier, a significant amount of disruption due to drawing revision would not have occurred.
3. A major longstanding problem that is causing delay and disruption is in obtaining legible sepia prints from the Reactor Plant Lead Yard which is necessitated to ensure proper construction of the reactor plant ventilation control air system.

1008

As of June 30, 1975, the Contractor has not received a satisfactory set of working drawings for this system from the Government's Reactor Plant Lead Yard. A second preliminary request for additional funding is being prepared for submittal to the Government as in response to a Change Order based on the increased complexity of the system and lack of adequate Government furnished information. If a contract change order is received for this system, then the price estimate for this work will be excluded from this proposal. In any event, the Contractor reserves all rights to equitable adjustment in the areas of delay and disruption that may result from problems associated with this system.

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TENNECO

June 4, 1975

Supervisor of Shipbuilding
Conversion and Repair, U. S. Navy
Newport News Shipbuilding and Dry Dock Company
Newport News, Virginia 23607

Subject: DLGN38 R.C. Ventilation Control Air System - Change Order Request

References:

(a) Ventilation Control Air Contract Diagram, Drawing 4385731

(b) Drawing 9572-19; Diagram - R.C. Ventialtion Control Air System Diagram (EB 38643-01X01)

(c) Drawing 9572-20: R.C. Ventilation Control Air Piping Fwd (EB 38643-15X01)

(d) Drawing 9572-21: R.C. Ventilation Control Air Piping Aft (EB 38643-15X02)

Dear Sir:

It has become evident that a serious discrepancy exists between the original estimate for the reactor compartment ventilation control air system and the actual system requirements for material and labor. Research into the original estimate has revealed the cause of the underestimate to be the misleading words in Section 9890-1 of the Specifications for Building Nuclear Powered Guided Missile Frigate DLGN38 that imply the ventilation system will be similar to that provided on the DLGN36 Class and shall be in accordance with the working drawings.

"9890-1-a, General

Two reactor plants similar to those provided in the DLG[illegible] working [illegible] (s) [illegible]

> Component Applicability List and Component Technical Specifications, to be furnished by the Government or prepared by the Contractor as specified in 9980-1-h. These working drawings, Component Technical Requirements (CTR's); Component Applicability List, and Component Technical Specifications shall be used without deviation unless specifically approved by NAVSHIPS 08 or its designated representative."

Since the working drawings were not available at the time of the original estimate, and due to the wording in the applicable section of the detail building specifications, the original estimate was developed from the misleading implication that this system would be basically the same as that on DLGN36 and therefore the contract guidance drawing, reference (a), would be acceptable to use in preparation of this estimate. This estimate contained no provisions for increased piping requirements since component locations were not specified on the contract diagram, no provision was made for quality inspection and certification due to the change from non-nuclear on DLGN36/37 to nuclear on DLGN38 Class and no provision was made for the added testing requirements due to the increased size and complexity of the system.

When the system diagram, reference (b), was received in July 1973 it became obvious that the original estimate was inadaqaute as to the necessary component requirements, however, no increase in piping could be determined from this diagram either, since the component locations were still not specified., Subsequently HMR 445 was received which corrected a small [illegible] changes [illegible] the added components [illegible]

[illegible]

The first significant problem in making the original estimate from the contract diagram and preparation of HCR 145 estimate from the system diagram was the inability of the estimators to determine the length of piping required in the ventilation control air system. This data is required to calculate the material requirements which in turn forms the basis for the manhour estimate. Consequently, the original system estimate and HCR 145 estimate do not include the required material and manhour requirements necessary for construction of this system.

The second element that contributed to this deficiency was the oversight of the Contractor's personnel to recognize that this system had changed from non-nuclear on DLGN36 to nuclear on DLGN38 with all the attendant inspection and certification requirements for which no manhours have been allotted. This oversight is attributed to the misleading words in the shipbuilding specifications.

The third factor that seriously affected the system estimate was the assumption made by the Contractor's Cost Engineering and Design Engineering personnel that the system test fitting and manhour requirements had not increased significantly since the system was thought to be non-nuclear and similar to that on DLGN36. This problem was identified to the Government, by letter 601/1-13-601-2681-DRPD 2681/15 dated November 19, 1974, as an increase in scope of the DLGN38 Acceptance Test Program. The response to this problem from the Government was received on December 11, 1974, in their letter 09-9030-SER 03J-8411 dated December 10, 1974, which stated that we had adequate information in the contract guidance drawing available to foresee these requirements. This statement was made even though the Government was aware that no test procedures were available to the Contractor at the time of [illegible] drawings or [illegible] system [illegible] requirements were extensively increased, been available to the Contractor at the time of bid preparation, a completely different system with all of its ramifications would have been revealed. Hence, because of the vagueness of the contract diagram and the absence of any working drawings, test procedures and appropriate wording in the shipbuilding specifications, the Contractor in good faith based his bid on the system employed in the DLGN36 Class.

Based on these facts, it is apparent that adequate information was not available to estimate properly the construction costs for the reactor compartment ventilation control air system.

In addition to the estimate discrepancy, a significant number of recent design development problems have come up that have increased engineering and material costs and are presented as follows:

1. The diagram for the reactor compartment ventilation control air system (NN Dwg. 9572-19) requires the pressure switch and transmitter components to meet the submersibility operational requirements. Since the Contractor was unable to purchase components that would meet this criteria, it was decided to relocate these components outside of the core removal compartment in the passageway. Subsequently, the Government design personnel decided that relocating these components did not satisfy the submersibility requirements and therefore would require a water tight enclosure. The water tight enclosures are presently being developed from a Reactor Plant Lead Yard sketch (DLGN38-P-[illegible] [illegible] work [illegible] direct result of meeting [illegible] [illegible] ical [illegible] by

a non-existent source of components that would meet the submersibility operational requirements.

2. Three Plan Revision Notices (PRNs) have been received and incorporated to include missing information and to resolve a major foul. Specifically PRN-A-747 (#2 Plant) was issued to clear a major foul with the charging system. This necessitated significant rework of the Contractor's drawing 9572-21, and added material requirements. PRN-A-743 (#2 plant) and PRN-A-742 (#1 plant) added missing information to the control air system drawings, 9572021 and 9572-20. Had this information been available earlier, a significant amount of disruption due to drawing revision would not have occurred.

3. A major longstanding problem that is causing delay and disruption is in obtaining legible sepia prints from the Reactor Plant Lead Yard which is necessary to ensure proper construction of the reactor plant ventilation control air system.

In order to correct the extreme disparity in the estimate for this system, resulting from unavailable Government furnished information and Reactor Plant Lead Yard drawing deficiencies, the Contracting Officer is hereby requested to confirm in writing that the aforementioned constitutes a change order. As soon as this matter is resolved, and since sufficient [illegible] is not available to enable us to develop a contract pricing proposal which meets your requirements, [illegible] proposal for equitable adjustment of price and [illegible] schedule on account of the aforementioned change order.

[redacted]

Memorandum

NN FORM 1-2 REV. 11/

DATE 6/16/75

TO: File

FROM:

SUBJECT:

A copy of the attached comment was handed to Alex on 6/16/75.

#7

01194

PUT IT IN WRITING
AVOID MISTAKES

00054

[redacted]

COST ENGINEERING CHRONOLOGY OF [illegible]
VENTILATION CONTROL AIR SYSTEM

1. THE COST [illegible] WAS ESTABLISHED FOR [illegible]. AT THE TIME OF THE ORIGINAL PROPOSAL, EVEN THOUGH THE CONTRACT GUIDANCE DIAGRAM (800-438 5731) [illegible] AND [illegible], THERE WAS SOME CONFUSION AS TO WHETHER THIS WAS A NUCLEAR OR A NON-NUCLEAR SYSTEM. CONSEQUENTLY, ONLY THE H.P. AIR PORTION UPSTREAM OF VA-15, 32, & 23 WAS INCLUDED IN OUR PROPOSAL (EST AS NON-NUCLEAR

2. IT WAS LATER RECOGNIZED THAT WE HAD NOT INCLUDED THE TOTAL COST AND THAT THIS WOULD BE A NUCLEAR SYSTEM.

3. WHEN NNS RECEIVED REV. "B" OF THE EB WORKING DIAGRAM (38643-01X01) WE REQUESTED AN FMR FOR THE DIFFERENCES FROM THE ORIGINAL GUIDANCE DIAGRAM. THE ORIGINAL ORDER-OF MAG. CHANGE (NN 337. WAS LATER CHANGED TO NN CHG 493-HMR 145,

4. REV. "C" OF THE E.B. WORKING DIAGRAM WAS RECENTLY RECEIVED BY NNS, BUT THRU DISCUSSIONS WITH DRPD (H. BLANKENSHIP & S. FRYER) WE WERE ASSURED THAT THIS REV. DOES NOT INVOLVE ANY FURTHER CHANGES IN LABOR AND MATERIAL FOR WHICH WE COULD REQUEST AN FMR.

5. COST ENGINEERING DID NOT AGREE WITH THE CHRONOLOGY ON THE CONTROL AIR SYSTEM AS PRESENTLY WRITTEN. A COPY HAS BEEN MARKED UP BASED ON THE FACTS AS KNOWN AND EXPLAINED IN ITEMS 1 THRU 4 ABOVE.

6/13/75

6/13/75

5.2.5 – Control Air System no more inadequate than any other contract guidance plan

as the [illegible] difference [illegible] DLGN38

An inadequate Government plan, contract guidance plan DLGN38-800-4385731, and ambiguity in Section 9590-1 of the Specifications for Building Nuclear Powered Guided Missile Frigate DLGN38 caused the Contractor to incur costs not contemplated at the time of contract execution. Section 9890-1a, PROPULSION: NUCLEAR POWER, General, provides that two reactor plants similar to those provided in the DLGN36 Class will be installed in the DLGN38 Class. This same specification section, 9890, provides that reactor plant ventilation system fans, filters, valves, and instruments shall be in accordance with contract guidance plan DLGN38-800-4335731; however, this plan was unavailable to the Contractor prior to definitization of the contract. The Contractor was therefore unable, or in any case failed, to determine from these documents that the DLGN38 reactor plant ventilation system was to be considered a nuclear system and not a non-nuclear system as was the case with the DLGN38 36 Class. Neither was the Contractor in a position to quantify any differences which could be reflected on the unavailable contract guidance plan. On that basis, therefore, the Contractor assumed that the contract design for

THE MAJOR DIFFERENCE COULD BE DETERMINED FROM SECTION

the DLGN38 Class ventilation system would be similar to that on the DLGN36

9590-1 ALSO FROM THE PLANS

Class and executed the contract accordingly.

NOT TRUE SIDE EST. AS NON NUCLEAR

PLAN WAS AVAILABLE

In the case of the DLGN38 ventilation system, not only was the design

NOT TRUE FOR BASIC DESIGN

of this system still evolving at the time bids were being prepared, but continued long after finalization of the contract. As the design developed, it became apparent that the control air system for DLGN38 was significantly more complex and would require more material and manhours than the system employed

NOT TRUE

on the previous ships. This was first illustrated in July 1973, when the system diagram, No. 9572-19 was received. (The material changes on this diagram subsequently resulted in receipt of HMR 145 which corrected a portion of the

component and fitting requirements.) After receipt of the control air piping working drawings which became available on November 21, 1974 (Forward Plant) and October 1, 1974 (Aft Plant), it became evident that the original estimate for the reactor compartment ventilation control air system was greatly understated.

Even after receipt of these plans, the data contained therein were so deficient as to preclude meaningful analysis. One significant problem in making the original estimate from the contract diagram and preparation of RMR 145 estimate from the system diagram was ~~[illegible]~~ — SUFFICIENT INFORMATION FOR the estimators to determine the length of piping required in the ventilation control air system. These data are required to calculate the material requirements which in turn forms the basis for the manhour estimate. Consequently, the original system estimate and RMR 145 estimate do not include the required material and manhour requirements necessary for construction of this system.

WHAT ESTIMATE

THE DIAGRAM WAS NOT HE[illegible]

The second element that contributed to this deficiency was the oversight of the Contractor's personnel to recognize that this system had changed from non-nuclear on DLGN36 to nuclear on DLGN38 with all the attendant inspection and certification requirements for which no manhours have been allotted. This oversight is attributed to the misleading words in the shipbuilding specifications.

The third factor that seriously affected the system estimate was the assumption made by the Contractor's Cost Engineering and Design Engineering personnel that the system test fitting and manhour requirements had not increased significantly since the system was thought to be non-nuclear and similar to that on DLGN36. This problem was identified to the Government, by letter 601/1-13-601-2681-DRPD 2681/15 dated November 19, 1974, as an increase in scope of the DLGN38 Acceptance Test Program. The response to this

problem from the Government was received on December 11, 1974, in their letter 08-9080-SER 083-8411 dated December 10, 1974, which stated their opinion that we had adequate information in the contract guidance drawing available to foresee these requirements. This statement was made even though the Government was aware that no test procedures were available to the Contractor at the time of bid preparation. Had these test procedures, or NOT SUPPLIED FOR BID system working drawings or ? appropriate wording in the shipbuilding specifications noting that the system requirements were extensively increased, been available to the Contractor at the time of bid preparation, a completely different system with all of its ramifications would have been revealed. Hence, because of the NOT vagueness of the TRUE contract diagram and the NORMAL CONDITION absence of any working drawings, test procedures and appropriate wording in the shipbuilding specifications, the Contractor in good faith based NO BID his bid on the system employed in the DLGN36 Class. There should be no question as to whether the data furnished by the Government misled the Contractor. WHAT ESTIMATE The detail of the Contractor's estimate clearly reveals that he was misled. That the data itself was deficient is supported by the fact that it also misled the Government personnel who reviewed the Contractor's estimate. ? Based on these facts, it is apparent that adequate information was not available to estimate properly the construction costs for the reactor compartment ventilation control air system.

In addition to the estimate discrepancy, a significant number of design development problems have come up that have increased costs and are presented as follows:

1. The diagram for the reactor compartment ventilation control air system (NN Drawing 9572-19) requires the pressure switch and transmitter components to meet the submersibility operational requirements. Since the Contractor was unable to

purchase components that would meet this criteria, it was decided to relocate these components outside of the core removal compartment in the passageway. Subsequently, the Government design personnel decided that relocating these components did not satisfy the submersibility requirements and therefore would require a water tight enclosure. The water tight enclosures are presently being developed from a Reactor Plant Lead Yard sketch (DLGN36-P-287). This added work is a direct result of meeting design criteria of an impractical nature as illustrated by a non-existent source of components that would meet the submersibility operational requirements.

2. Three Plan Revision Notices (PRNs) have been received and incorporated to include missing information and to resolve a major foul. Specifically, PRN-A-747 (#2 plant) was issued to clear a major foul with the charging system. This necessitated significant rework of the Contractor's drawing 9572-21, and added material requirements. PRN-A-743 (#2 plant) and PRN-A-742 (#1 plant) added missing information to the control air system drawings, 9572-21 and 9572-20. Had this information been available earlier, a significant amount of disruption due to drawing revision would not have occurred.

3. A major longstanding problem that is causing delay and disruption is in obtaining legible sepia prints from the Reactor Plant Lead Yard which is necessary to ensure proper construction of the reactor plant ventilation control air system.

As of January 1, 1975, the Contractor has not received the complete set of working drawings for this system from the Government's reactor plant

lead yard. A second preliminary request for additional funding is being prepared for submittal to the Government as in response to a Change Order based on the increased complexity of the system and lack of adequate Government furnished information. ? If a contract change order is received for this system, then the price estimate for this work will be excluded from this proposal. In any event, the Contractor reserves all rights to equitable adjustment in the areas of delay and disruption that may result from problems associated with this system.

?? IS THIS WRITE UP OR
THE WRITE UP FOLLOWING
THE ONE SET. OF 6/17/75 IS
BASED ON ?? 429

5.2.8 Control Air System

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In the case of the DLGN38 ventilation system, not only was the design of this system still evolving at the time bids were being prepared, but continued long after finalization of the contract. As the design developed, it became apparent that the control air system for DLGN38 was significantly more complex and would require more material and manhours than the system employed on the previous ships. This was first illustrated in July 1973, when the system diagram, No. 9572-19 was received. (The material changes on this diagram subsequently resulted in receipt of MCR 145 which corrected a portion of the

component and fitting requirements.) After receipt of the control air piping working drawings which became available on November 21, 1974 (Forward Plant) and October 1, 1974 (Aft Plant), it became evident that the original estimate for the reactor compartment ventilation control air system was greatly understated.

Even after receipt of these plans, the data contained therein were so deficient as to preclude meaningful analysis. One significant problem in making the original estimate from the contract diagram and preparation of HDR 145 estimate from the system diagram was the inability of the estimators to determine the length of piping required in the ventilation control air system. These data are required to calculate the material requirements which in turn forms the basis for the manhour estimate. Consequently, the original system estimate and HDR 145 estimate do not include the required material and manhour requirements necessary for construction of this system.

The second element that contributed to this deficiency was the oversight of the Contractor's personnel to recognize that this system had changed from non-nuclear on DLGN36 to nuclear on DLGN38 with all the attendant inspection and certification requirements for which no manhours have been allotted. This oversight is attributed to the misleading words in the shipbuilding specifications.

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lead yard. A second preliminary request for additional funding is being prepared for submittal to the Government as in response to a Change Order based on the increased complexity of the system and lack of adequate Government furnished information. If a contract change order is received for this system, then the price estimate for this work will be excluded from this proposal. In any event, the Contractor reserves all rights to equitable adjustment in the areas of delay and disruption that may result from problems associated with this system.

#10

13. When the contract contains cost incentives, any sums paid to the contractor on account of economic price adjustment provisions shall be subtracted from the total of the contractor's allowable cost for the purpose of establishing the total costs to which the cost incentive provisions apply. If the incentive arrangement is cited in percentage ranges rather than dollar ranges, above and below target costs, the economic price adjustment clause should be structured to maintain the original contract incentive range in dollars.

14. The economic price adjustment clause should provide that once the labor and material allocations have been established, they remain fixed through the life of the contract and are not modified except in the event of partial termination of the contract. The clause should state that pricing actions pursuant to the Changes clause or other provisions of the contract will be priced as though there were no provision for economic price adjustment.

(d) Consistent with the factors set forth in (c)(3)*b* above, the contracting officer may also determine it appropriate to provide for certain economic price adjustment arrangements between the prime contractor and subcontractors to properly allocate risks. In such circumstances, provision for incorporation of price adjustment clauses in specified subcontracts should be included in the price adjustment provision of the prime contract.

(e) When economic price adjustment provisions are included in contracts that do not require submission of cost or pricing data as provided for in 3–807.3, it will be the responsibilty of the contracting officer to obtain adequate information to establish the base line from which adjustments will be made. In addition, the contracting officer may require verification of the data submitted to the extent considered necessary to permit reliance upon it as a reasonable base line.

3–404.4 *Fixed-Price Incentive Contracts.*

(a) *Description.*

(1) *General.* The fixed-price incentive contract is a fixed-price type contract with provision for adjustment of profit and establishment of the final contract price by a formula based on the relationship which final negotiated total cost bears to total target costs.

(2) *Firm Target.* Under this type of incentive contract there is negotiated at the outset a target cost, a target profit, a price ceiling (but not a profit ceiling or floor), and a formula for establishing final profit and price. After performance of the contract, the final cost is negotiated and the final contract price is then established in accordance with the formula. When the final cost is less than target cost, application of the formula results in a final profit greater than the target profit; conversely, when final cost is more than target cost, application of the formula results in a final profit less than the target profit, or even a net loss. Thus, within the price ceiling, the formula provides for the Government and the contractor to share the responsibility for costs greater or less than those originally estimated, as determined by a comparison of negotiated final cost with target cost. Because the profit resulting from application of the formula is in inverse relationship to costs, the formula provides the contractor in advance with a calculable profit incentive to control costs. To provide an incentive consistent with the circumstances, the formula should reflect the relative risks involved in contract performance. Thus it is appropriate in certain procurements to establish a formula which provides for contractor assumption of a considerable or major

share of total cost responsibility. In such circumstances, when a major share of total cost responsibility is assumed by the contractor, every consideration will be given to establishing target profits which reflect assumption of such responsibility.

(3) *Successive Targets.* Under this type of incentive contract, there is negotiated at the outset an initial target cost, an initial target profit, a price ceiling, a formula for fixing the firm target profit, and a production point at which the formula will be applied. Generally, the production point will be prior to delivery or shop completion of the first item. This formula does not apply for the life of the contract but simply is used to fix the firm target profit for the contract. The initial formula shall also provide for a ceiling and floor on the firm target profit. To provide an incentive consistent with the circumstances, the formula for fixing the firm target profit should reflect the relative risk involved in establishing an incentive arrangement where cost and pricing information were not sufficient to permit the negotiation of firm targets at the outset (see (b)(3) below). Thus it normally will not provide for as great a degree of contractor cost responsibility as would a formula for establishing final profit and price. When the production point for applying the formula is reached, the firm target cost is then negotiated, consideration being given to experienced cost and all other pertinent factors, and the firm target profit is automatically determined in accordance with the formula. At this point, two alternatives are possible. First, a firm fixed price may be negotiated using as a guide the firm target cost plus the firm target profit. Second, if use of the firm fixed price is determined to be inappropriate, a formula for establishing final profit and price may be negotiated, using the firm target profit and the firm target cost. As in the firm target type of contract described in (a)(2), the final cost is negotiated at the completion of the contract and the final contract price is then established in accordance with the formula for establishing final profit and price.

(4) *Billing Price.* In either of the above types of contract, a billing price will be established as an interim basis for payment. This billing price may be adjusted within the ceiling limits, upon request of either party to the contract, when it becomes apparent that final negotiated costs will be substantially different from the target cost.

(b) *Application.*

(1) Fixed-price incentive contracts are appropriate when use of the firm fixed-price contract is inappropriate, and the supplies or services being procured are of such a nature that assumption of a degree of cost responsibility by the contractor is likely to provide him with a positive profit incentive for effective cost control and contract performance. It may also be appropriate to negotiate additional incentive provisions covering performance levels and more timely delivery (see 3–407.2). Contract performance requirements must be such that there is reasonable opportunity for the incentive provisions to have a meaningful impact on the manner in which the contractor manages the work. Separate incentive provisions may be made applicable to individual line items of a contract, *e.g.*, when dissimilar work is best incentivized by use of separate formulas.

(2) The firm target type of incentive contract, described in (a)(2) above, is appropriate for use whenever a firm target and a formula for establishing final profit and price can be negotiated at the outset which will provide a fair and reasonable incentive.

(3) The successive targets type of incentive contract, described in (a)(3) above, is appropriate for use whenever available cost and pricing information is not sufficient to permit the negotiation of realistic firm targets at the outset. However, enough information should be available to permit negotiation of initial targets, and there should be reasonable assurance that additional reliable information will be available at an early point in the performance of the contract so as to permit negotiation of either a firm fixed price, or firm targets and a formula for establishing final profit and price, which will provide a fair and reasonable incentive. The additional information need not in all cases come from experience under the contract itself, but may be drawn from experience on any other contracts for the same or similar items.

(c) *Limitations*. Fixed-price incentive contracts shall not be used unless the contractor's accounting system is adequate for price revision purposes and permits satisfactory application of the profit and price adjustment formulas. In no case should such contracts be used where (i) cost or pricing information adequate for firm targets is not available at the time of initial contract negotiation or at a very early point in performance, or (ii) the sole or principal purpose is to shift substantially all cost responsibility to the Government. In no case shall the firm target profit or the formula for final profit and price be established independently. Simultaneous, not sequential, agreement will be reached on all the elements of the pricing agreement. Neither type of fixed-price incentive contract shall be used unless a determination has been made, in accordance with the requirements of Part 3 of this Section III, that:

(i) such method of contracting is likely to be less costly than other methods, or

(ii) it is impractical to secure supplies or services of the kind or quality required without the use of such type of contract.

3–404.5 *Prospective Price Redetermination at a Stated Time or Times During Performance.*

(a) *Description*. This type of contract provides for a firm fixed price for an initial period of contract deliveries or performance and for prospective price redetermination either upward or downward at a stated time or times during the performance of the contract. It also may provide for a price ceiling, where appropriate. Once established, ceiling prices are subject to adjustment only by reason of the operation of other contract clauses (see 3–404.1).

(b) *Application*. This type of contract is appropriate in procurements calling for quantity production or services where it is possible to negotiate fair and reasonable firm fixed prices for an initial period, but not for subsequent periods of contract performance. This initial period should be the longest period for which it is possible to establish fair and reasonable firm fixed prices at the time of original negotiation. The length of the prospective pricing periods should depend on the circumstances of each case and should generally be at least twelve months each. Ceiling prices, where appropriate, should be based on the evaluation of the uncertainties involved in contract performance, and their possible impact on cost, and should be negotiated at a level which represents contractor assumption of a reasonable degree of risk.

(c) *Limitations*. This type of contract shall not be used unless:

[illegible] REC'D 4/18/75
[illegible] and mandatory for [illegible]
[illegible] test requirements. [illegible]

REVIEW OF VENTILATION CONTROL AIR SYSTEM

At the request of the claims group, Jim Collins we were asked to review the subject system to determine what costs were included in our original H601 proposal. The following is the results of this review:

1- On H 595 & 596 this system was included in cost number 6454 as a non-nuc system.

2- This system was redesigned for H60 At the time of our original propos even though the contract guidance dia (500-4355731) was issued and available, there was some confusion as to whet this was a nuclear of a non-nuclear system. Consequently, only the H.P. Air Pattern upstream of VA 15, 22 & 23 was included in our proposal.

3. It was later recognized that we had not included the ~~total~~ cost and the this would be a nuclear system.

4- When NNS received REV"B" of the EB Working Diagram (38643-01K01) we req an FJR for the differences from the Original guidance diagram. The original Order-of Mag. change (NN 337) was later changed to NN: chg 498 - HMR 145.

5- Rev. "C" of the E.P. working diagram was recently received by NNS, but thru discussions with DRPDI (H. Blankenship & [illegible]) we were assured that this Rev. does not involve any further changes in labor and material for which we could request an FM

6- The attached is our estimate of the ~~total~~ cost of the ventl. control air system based on the latest information available. From this estimate we have deducted the amounts included in the original estimate and NN Chg 499. The balance is what has not been included in any H601 ESTIMATE.

7- This estimate has been de-escalated to the base month for H601 - June 1

8- The H601 estimate includes certain first ship costs which we have noted & and made adjustments before calculating the DLGN 41 & 42 COSTS. No ADJ. HAS BEEN INCLUDED FOR LEARNI

4-11-75

DLGN 41/42

H601 VENTILATION CONTROL AIR SYSTEM [illegible]

		MAT'L	LABOR	OTD
*H601 DE ESCAL FINAL (JUNE 70)	8,288	99,852	15,010	4,503
ORIG EST HP SIDE (JUNE 70)	2,750	25,723	1,170	0
EST HMP. 145 (JUNE 70) see pg 55	700 EST	9,623	116	25
			13,724 M/H	4,475
NET DIFFERENCE FOR H601 (AMOUNT NOT INCL. IN ANY H601 EST)	4,838 #	$64,536 ✓	18,199 M/H ✓	
H601 TO DLGN 41 & 42 ADJUSTMENTS FOR NON-RECURRING COSTS	- 0	$ -23,641	- 1,356 M/H	
NET DIFFERENCE FOR DLGN 41 & 42 (JUNE '70) (AMT. NOT INCL. IN ANY DLGN 41 & 42 EST)	4822 #	$40,295	16,843 M/H	
MAR '75 PRICE				
$\frac{\text{MAR '75}}{\text{JUNE '70}} = \frac{181.7}{113.3} = 1.604 \times \$40,895 =$		$65,596	16,843	
SAY		65,600	16,800 M/H	

*INCLUDES 1ST SHIP COST (SOFTWARE, CONSTRUCTION SPARES AND NRC) SOME OF WHICH WOULD NOT BE APPLICABLE TO DLGN'S 41 & 42.

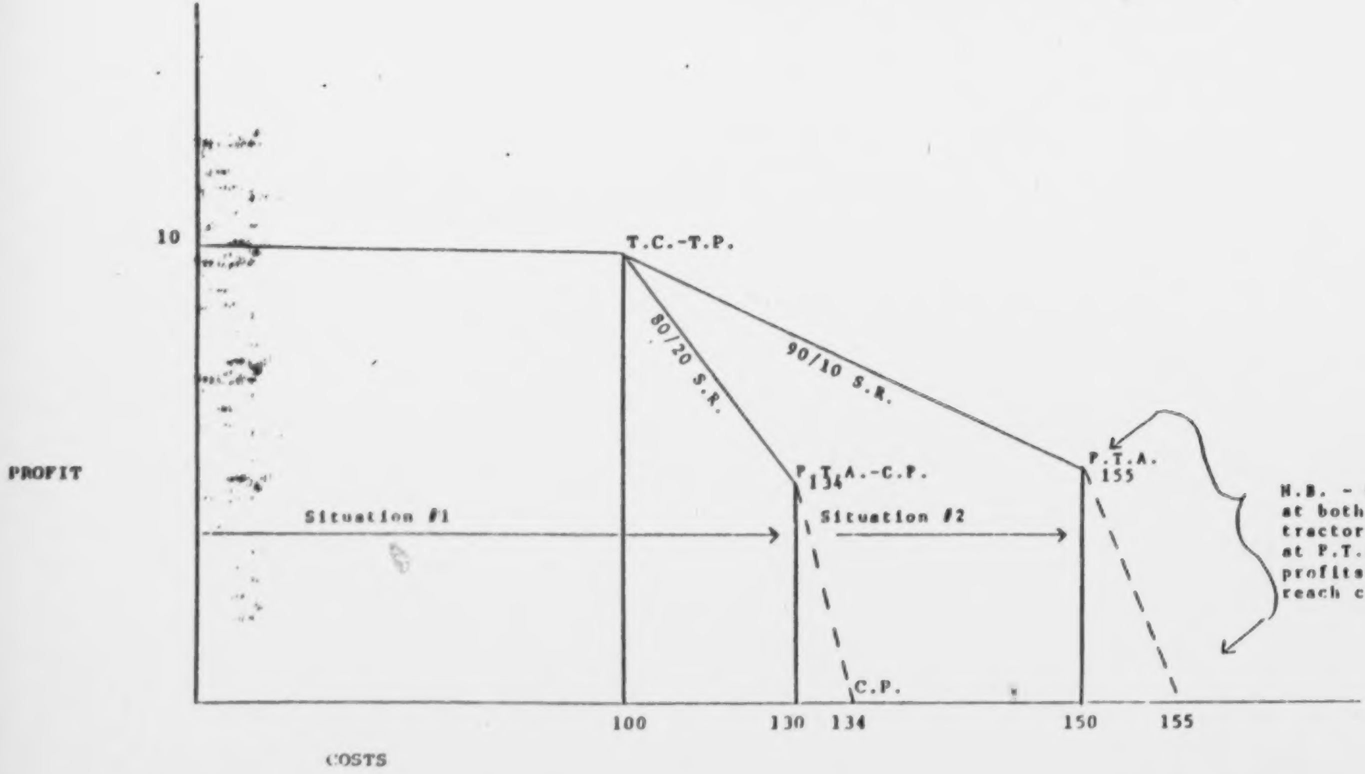
Jim, Did you talk to Contracts about a possible H601 change? Do we need to do anything else & notify A.S.T.

CH 14-16-75

12

THE FIXED PRICE INCENTIVE FEE CONTRACT

SCHEDULE A



N.B. - Gov. pays same at both points - contractor makes profit at P.T.A. but no profits when his costs reach ceiling

In aid of understanding the graphic portrayal of the fixed price incentive fee contract, the following figures are assumed:

Target Cost (TC)	-	$100M
Target Profit (TP)	-	10M
Ceiling Price (CP)	-	134M
Share Ratio *80/20		
**Point of total assumption (P.T.A.)		$134M

SITUATION #1 - Assume the Contractor's costs are $130M. He gets the following: (a) his costs - $130M - (b) a profit - $4M- that is diminished (absolutely and as a % of cost) since he is penalized for his $30M cost overrun - the math is as follows: - $30 X 20% =$6M $10 (T.P.) - $6M = $4M; for a total of (c) $134M. This is ceiling for the government - i.e., it will pay no more, although the contractor has received a profit and will continue so until his cost reach $134 (see graph).

SITUATION #2 - This illustrates a method by which in negotiations the share ratio, CP and P.T.A. can be adjusted without changing the T.C. figure. The adjustments are as follows: Share ratio changed to 90/10; C.P. - P.T.A. to $155M

* Government's % figure appears on left

** The P.T.A. is when the government reaches ceiling, i.e., will pay no more, although the contractor still makes profit. In his claims effort the contractor seeks to push T.C. and most importantly P.T.A. to the right on the graph, i.e., increase the figures.

#13

9890-1-a. General

Two reactor plants similar to those provided in the DLGN 36 Class shall be installed in accordance with working drawings, component Technical Specifications, and material specifications to be furnished by the Government. These working drawings, component Technical Specifications, and material specifications shall be used without deviation unless specifically approved by NAVSHIPS 08 or its designated representative.

9890-1-b. Scope of Government Furnished Drawings

The Government furnished working drawings will be based on the contract drawings and contract guidance drawings and will cover the following areas:

1. Reactor plant fluid systems as defined on contract guidance drawings DLGN 38 800-4385710 through 800-4385731.
2. Reactor compartment ventilation and blowoff system except for arrangement of supply and exhaust ducting from the main deck fan room boundaries to the weather.
3. Reactor plant control, instrumentation and electrical systems including propulsion plant interior communication circuits associated with reactor plant equipment.
4. Arrangements
    - a. Reactor compartments
    - b. Machinery spaces - engine rooms and auxiliary rooms including only that equipment associated with reactor plant systems
    - c. Enclosed operating stations
    - d. Propulsion plant personnel decontamination stations, tool decontamination rooms and decontamination laundry
    - e. Nucleonics rooms
5. Shielding arrangements and details including polyethylene fabrication and installation instructions
6. Shielded penetrations - arrangements and details
7. Radiological controls and marking associated with the propulsion plant including the radiation monitoring system
8. Lifting and handling gear to be provided by the Contractor for maintenance of reactor plant equipment
9. Structural
    - a. Primary shield tank and reactor compartment stanchions
    - b. Secondary shield bulkhead
    - c. Reactor compartment support level
    - d. Foundations for selected reactor plant equipment (nominally those weighing in excess of 50 pounds) as indicated on contract guidance draw- DLGN 38-800-4385739 through 800-4385744. Foundation drawings and reactor plant structural drawings will include any reinforcement of ship's structure required by the reactor plant equipment.
    - e. Shielded reactor servicing, control rod drive mechanism removal, access, and coolant pump removal hatches, shielded access doors, and reactor compartment innerbottom manways.
    - f. Structural vent trunks and blowoff ducts
    - g. Bulkheads for the reactor plant secondary control stations, tool decontamination rooms, decontamination laundry, and showers in the propulsion plant personnel decontamination stations
    - h. The portions of the second deck and its supporting structure within the secondary shield
    - i. The portions of the inner bottom plating including inner bottom man ways and bilge wells within the secondary shield.
10. Routes for reactor plant component removal and replacement
11. Thermal insulation schedule for reactor plant piping systems and components

The Government furnished working drawings will indicate where testing by the Contractor of Contractor furnished reactor plant equipment fabricated in accordance with these drawings, such as non-structural tanks, is necessary to meet the shock and vibration requirements of 9400-1 and 9400-2. These drawings will include the conditions for such testing and post testing inspection requirements. Any changes to the drawings resulting from this testing will be made by the Government. Items used for this testing may be used in the ship after being refurbished to like-new condition.

9890-1-c. Scope of Component Technical Specifications and Material Specifications

The applicable issues of Government furnished Technical and material Specifications shall be those in effect on 21 November 1969.

The Government furnished component Technical Specifications and material specifications will cover quality assurance requirements governing commercially purchased equipment and the following Contractor-furnished reactor plant items:

1. Reactor plant fluid system pumps, valves, instruments, and miscellaneous components as indicated on contract guidance drawings DLGN 38 800-4385710 through 600-4385731
2. Reactor compartment ventilation system fans, filters, valves, and instruments as indicated on contract guidance drawing DLGN 38 800-4385732
3. Coolant pumping power system switchboards and 15 hertz motor generator sets
4. Reactor plant temperature monitoring system, salinity indicating system, and instrumentation and control automatic bus transfer units

5. Reactor compartment ventilation control cabinets, pressurizer control cabinets, and pressurizer heater connection boxes

6. Controllers for reactor plant pumps, motor-operated valves, 15 hertz motor generator sets, fans, and charging pump head tank heaters

7. Low-manganese steel for nuclear instrument tubes, check source tubes, and associated supports

9890-1-d. Requirements for Contractor Review and Information

The Contractor shall be responsible for reviewing Government-furnished reactor plant working drawings, component Technical Specifications, and ~~material specifications~~ and informing NAVSHIPS 08 or its designated representative of any areas where the ship design, construction or operation cannot be made compatible with them.

A composite structural arrangement drawing and necessary off-sets for the basic hull structure directly affecting the preparation of the Government-furnished reactor plant working drawings will be provided to the Contractor for information within one month after contract award. Within four months after contract award the Contractor shall advise NAVSHIPS of any areas where the structural design to be developed by the Contractor cannot be made consistent with this composite structural arrangement drawing.

The composite structural arrangement drawing to be provided to the Contractor will specifically identify selected non-reactor plant structure which has been included in reactor plant foundation dynamic shock analyses. Since any movement of, alteration of, or addition of non-reactor plant components on this structure may affect the validity of the applicable reactor plant foundation analysis, the Contractor shall obtain the concurrence of NAVSHIPS 08 or its designated representative in these actions.

The Contractor shall provide, to the Reactor Plant Lead Yard, wiring diagrams for Contractor furnished reactor plant electrical equipment and dimensioned outline drawings (including weight, center of gravity and method of mounting) of all Contractor furnished equipment specified on the reactor plant working drawings. This information shall be provided at least 30 days prior to the release for manufacture of any such item. Any changes required to the reactor plant working drawings to accommodate this equipment shall be specifically identified in these submittals.

The Contractor shall provide to the Reactor Plant Lead Yard the initial issue and all revisions to those drawings which affect the development of the Government furnished reactor plant working drawings as identified by the Reactor Plant Lead Yard. These drawings shall include the following:

1. Compartment and access drawings for those areas in which arrangement change require NAVSHIPS 08 approval as defined in Section 9900-1;

2. Propulsion plant machinery arrangements;

3. Propulsion plant fan room arrangements;

4. Reactor compartment ventilation exhaust ducts from the main deck fan rooms to the weather;

5. Structure in way of the propulsion plants, propulsion plant fan rooms, core removal areas, spaces containing reactor compartment ventilation system ducting shown on Government furnished drawings, and spaces containing reactor plant cross-connect piping between propulsion plants.

6. Selected piping, electrical wireways, power and lighting systems, ventilation systems, and foundations located in the propulsion plants, propulsion plant fan rooms, core removal areas, spaces containing reactor compartment ventilation system ducting shown on Government furnished drawings, and spaces containing reactor plant cross-connect piping between propulsion plants.

The Contractor shall provide the initial issue and revisions of the working drawing index to the Reactor Plant Lead Yard. The Reactor Plant Lead Yard will identify from this index those drawings to be provided by the Contractor.

9890-1-e. Reactor Plant Material Specifications

Where the following specifications are invoked on Government furnished reactor plant working drawings, the revisions and modifications, indicated below, are intended and shall apply. Reference to notes following this listing indicates that the notes referenced contain modifications to the specification which are applicable and shall or may be used as indicated.

1. Stainless steel seamless pipe and tubing, composition 304 - MIL-T-23226B including Amendment 1.

2. Stainless steel fittings and flanges, composition 304 - MIL-F-23467B including Amendment 1. Note (7) applies.

3. Nickel-chromium-iron seamless pipe and tubing - MIL-T-23227B including Amendment 1 dated 11 August 1969.

4. Nickel-chromium-iron fittings and flanges - MIL-F-23508B including Amendment 1 dated 11 August 1969. Notes (5) and (7) apply.

5. Nickel-copper alloy (70-30) seamless pipe and tubing - MIL-T-23520A including Amendment 1.

6. Nickel-copper alloy (70-30) fittings and flanges - MIL-F-23509B including Amendment 1. Notes (6) and (7) apply.

7. Carbon steel seamless pipe - MIL-P-24338 including Amendment 1. Note (2) is applicable as an option. Note (3) applies.

SECTION 9020-1
DRAWINGS

9020-1-a. General

This section contains requirements pertaining to type, preparation, approval procedure, indexing, microfilming, and distribution of drawings and drawing booklets.

Supplementary requirements for specific installations, structures, machinery and equipment systems, and technical manuals and publications are contained in other sections of these specifications.

All drawings, booklets, microfilm of drawings and indexes requiring approval shall be submitted as required herein.

Additional copies are required of drawings showing installation of equipment furnished by, or of drawings of structures and systems directly associated with the proper functioning of equipment under the cognizance of various Government activities. In these cases, the Supervisor will designate the number of additional copies required.

Table 1 lists documents which shall be submitted to NAVSHIPS for initial approval. After initial approval, only those drawings having revisions or revised notes incorporating design changes shall be submitted for approval.

Government approval of drawings shall not relieve the Contractor of his obligation to meet the requirements in these specifications.

Drawings, including reproducibles and prints, required to be furnished by the Contractor to NAVSHIPS or its representatives shall become the property of the Government.

Drawings shall be annotated with a distribution limitation statement in accordance with NAVSHIPS Instructions, located above the title block so that it will be visible when print is folded.

If defects develop in machinery or equipment during the guarantee period, and if corrections of such defects are determined to be the responsibility of the Contractor, he shall revise the Government set of drawings to show modifications made to correct such defects; or if preferred by the Contractor, new correct drawings may be furnished.

Propulsion plant system diagrams shall be revised throughout the construction period, as necessary to reflect the current system design.

9020-1-b. Definitions

Contract drawings are NAVSHIPS drawings forming part of the specifications which illustrate design features of the ship from which no departure in the development of drawings by the Contractor is permitted unless such departure is specifically approved.

Contract guidance drawings are NAVSHIPS drawings forming part of the specifications and serve as an illustrative guide for developing working drawings.

Standard drawings are NAVSHIPS drawings illustrating arrangement and details of equipment, systems, materials, or components from which no departure in the manufacture of parts or intent of use is permitted without NAVSHIPS approval.

Type drawings are NAVSHIPS drawings illustrating systems or components which may be subject to development by the Contractor, to assure full compliance with these specifications.

Working drawings are Contractor construction drawings which are necessary for construction of the ship as required by these specifications.

Selected record drawings are a designated group of drawings made applicable to an individual ship and illustrate final shipboard installations of important features, systems, and arrangements.

Onboard drawings are a designated group of drawings, illustrating those features considered necessary for shipboard reference.

Manufacturer equipment drawings are drawings prepared by manufacturers of Government-or Contractor-furnished equipment which are identified by a manufacturer drawing number.

Reproducible drawings are drawings from which prints can be made.

Certification data sheets are supplemental manufacturer equipment drawings containing the manufacturer equipment data, procurement data, ship applicability, drawing references and other data as required by Mil. Spec. MIL-D-1000/2 and equipment specifications.

Final drawings are working drawings which have been corrected to illustrate final ship and system arrangement, fabrication, and installation.

Photographic Reproductions are those containing silver halides or silver salts as the sensitizing process (See Mil. Spec. MIL-D-5480, class 4).

9020-1-c. Government-furnished drawings

Contract drawings and contract guidance drawings will be furnished to the Contractor as part of the contract.

Upon the Contractor's request to the Supervisor, the Government will furnish reproductions of drawings of Government-furnished equipment as necessary for preparation of working drawings. See 9890-1 for Government-furnished reactor plant working drawings.

NAVSHIPS standard and type drawings are also available upon request. Refer to 5000-0 for effective date of revision applicable to the contract.

Items fully illustrated by drawings of Government-furnished equipment, or manufacturer equipment drawings shall not be redrawn by the Contractor. When these drawings apply, they shall be referenced by a drawing number on the applicable arrangement drawing, assembly drawing, or drawing list.

The following contract drawings and contract guidance drawings form part of these specifications. Wherever references such as "as shown on the drawings" or "as indicated on the drawings" are made in other sections of these specifications, it shall be understood to refer to the drawing(s) listed below:

HULL CONTRACT DRAWINGS

NAVSHIPS No. DLGN 38-800-	Title
4385677	General Arrangement - Outboard Profile
4385678	General Arrangement - Inboard Profile
4385679	General Arrangement - Main Deck and Above
4385680	General Arrangement - 2nd Deck and 1st Platform
4385681	General Arrangement - 2nd Platform and Below
4385682	Lines and Molded Offsets
4385683	Scantling Drawing Midship Section

HULL CONTRACT GUIDANCE DRAWINGS

NAVSHIPS No. DLGN 38-800-	Title
4385684	Scantling Drawing - Decks, Platforms and Framing
4385685	Scantling Drawing - Superstructure
4385686	Scantling Drawing - Shell Plating and Typical Sections
4385687	Scantling Drawing - Sonar Dome
4385689	Rudders and Rudder Supports, Shaft Struts, Shaft Fairing and Steering Gear - Arrangement
4385690	Replenishment-at-Sea - Connected Transfer and Helicopter Transfer - Arrangement
4385691	Helicopter and Boats Handling and Stowage - Arrangement
4385692	Anchor Handling and Stowage - Arrangement
4385693	Torpedo Countermeasures and Bathythermograph Installation - Arrangement
4385694	Gun Ammunition Handling and Stowage - Arrangement
4385695	Missile Handling and GMLS Installation - Arrangement
~~4385696~~	~~Weapon [illegible] Ship Interface - Mechanical~~
4385697	~~CHAFFROC and~~ Torpedo Installation, Handling and Stowage - Arrangement
4385698	Stores Handling and Stowage - Arrangement

MACHINERY CONTRACT GUIDANCE DRAWINGS

NAVSHIPS No. DLGN 38-800-	Title
4385701	Arrangement of Machinery - Reactor Compartment #1
4385702	Arrangement of Machinery - Reactor Compartment #2
4385703	Arrangement of Enclosed Operating Station for #1 Machinery Group
4385704	Arrangement of Enclosed Operating Station for #2 Machinery Group
4385705	Reactor Compartment Structure
4385706	Secondary Shield Above Innerbottom
4385707	Primary Shield Above Innerbottom
4385708	Innerbottom Shielding
4385709	Polyethylene Fabrication and Installation Procedure
4385710	Diagram - Reactor Coolant System
4385711	Reactor Coolant Piping - Plans and Sections
4385712	Diagram - Coolant Pressurizing System
4385713	Diagram - Coolant Purification and Sampling System
4385714	Diagram - Coolant Pressure Relief System
4385715	Diagram - Coolant Charging System
4385716	Diagram - Valve Operating System
4385717	Diagram - Reactor Plant Fresh Water Cooling System
4385718	Diagram - Reactor Fill System
4385719	Diagram - Reactor Plant Control Air System
4385720	Diagram - Primary Shield Water System
4385721	Diagram - Discharge Storage System
4385722	Diagram - Coolant Discharge System
4385723	Diagram - Reactor Compartment Containment Pressure Control System
4385724	Diagram - Reactor Plant Radiation Monitoring System
4385725	Diagram - Water Treatment System
4385726	Diagram - Evacuation and Purge System for Reactor Coolant System
4385727	Diagram - Steam Generating System - Main Steam
4385728	Diagram - Steam Generating System - Main Feed
4385729	Diagram - Steam Generating System - Blowdown and Sampling
4385730	Diagram - Steam Generating System - Safety Valve Escape
4385731	Diagram - Reactor Compartment Ventilation Control Air System

MACHINERY CONTRACT GUIDANCE DRAWINGS

NAVSHIPS No. DLGN 38-400-	Title
4385732	Diagram - Reactor Compartment Ventilation and Blowoff System
4385734	Nucleonics Room Arrangement, Engine Rooms #1 and 2
4385739	Arrangement of Machinery - Auxiliary Rooms #1 P and S
4385740	Arrangement of Machinery - Auxiliary Rooms #2 P and S
4385741	Arrangement of Machinery - Engine Room #1 - Plans
4385742	Arrangement of Machinery - Engine Room #1 - Sections
4385743	Arrangement of Machinery - Engine Room #2 - Plans
4385744	Arrangement of Machinery - Engine Room #2 - Sections
4385745	Diagram - Engine Room and Auxiliary Room Ventilation System
4385746	Diagram - Main Steam System
4385747	Diagram - Reduced Pressure and Reboiler Steam Systems
4385748	Diagram - Auxiliary Exhaust and Bleeder Steam System
4385749	Diagram - Main Feed System
4385750	Diagram - Condensate System
4385751	Diagram - Reserve Feed System
4385752	Diagram - Main and Auxiliary Circulating Water Systems
4385753	Heat Balance and Flow Diagram - 117% Full Power Cruise Condition
4385755	Arrangement - Emergency Generator Rooms and Diesel Air Intake and Exhaust Systems.
4385756	Arrangement - Air Cond. Refr., Pump, Prairie Compr. and Sew. Treat. Rooms
4385757	A/C, Vent and Heating Diagram - Main Deck and Above
4385758	A/C, Vent and Heating Diagram - 2nd Deck and 1st Platform
4385759	A/C, Vent and Heating Diagram - 2nd Platform and Below
4385760	Arrangement of Workshops
4385761	Diagrammatic Arrangement of Firemain, Washdown, Foam and Sprinkler Systems - 2nd Platform and Below
4385762	Diagrammatic Arrangement of Firemain, Washdown, Foam and Sprinkler Systems - Main Deck and Above
4385763	Diagrammatic Arrangement of Firemain, Washdown, Foam and Sprinkler Systems - 2nd Deck and 1st Platform
4385764	Diagrammatic Arrangement of JP-5 Filling, Transfer Service and Stripping System
4385765	Diagrammatic Arrangement of Compressed Air Systems
4385766	Diagrammatic Arrangement of Electronics Cooling Water Systems
4385767	Elex Clg, Mach/Aux Blr and Sewage Treat. Exh/Prairie Compr Air Intake and Waste Disposal Room
4385768	Diagrammatic Arrangement of Chilled Water System
4385769	Diagrammatic Arrangement of Potable Water System
4385770	Diagrammatic Arrangement of Soil and Waste Drains
4385771	Diagrammatic Arrangement of Main and Secondary Drainage Systems
4385809	Diagrammatic Arrangement of MK 26 Missile Water Injection System
4385810	Arrangement - Damage Control Central
4385811	Diagrammatic Arrangement of Sea Water, Air Conditioning and Miscellaneous Machinery Cooling Systems

ELECTRONIC CONTRACT DRAWINGS

NAVSHIPS No. DLGN 38-800-	Title
4385778	Voice Communication Matrix
4385779	Alarm Systems Matrix
4385780	Indicating Systems Matrix
4385781	Navigational System Matrix
4385782	IC Switchboards Interties System - Circuit "S"
4385787	Arr of Equip - Radar Rm No. 1
4385788	Arr of Equip - Radar Rm No. 2
4385789	Arr of Equip - Radar Rm No. 3
4385790	Arr of Equip - ECM Rm No. 1
4385791	Arr of Equip - ECM Rm No. 2
4385792	Arr of Equip - CIC Unattended Equip Rm
4385793	Arr of Equip - Computer Rm Nos. 1 and 2
4385795	Radar, IFF, Integrated Computer and Display Systems
4385796	Electronic Warfare System
4385797	Infrared, Radiac and Navigation Systems
4385798	Arr of Equip - Fwd and Aft IC and Gyro Rms
4385799	Pilot House and Bridge Wing Ship Control Consoles
4385800	Arr of Equip - Pilot House, Bridge Wings and Chart Rm

ELECTRONIC CONTRACT DRAWINGS

NAVSHIPS No. DLGN 38-800-	Title
4385801	Arr of Equip - CIC
4385802	Combat System - Block Diagrams
4385803	Combat System Interfaces
4385804	Arr of Equip - Msl Dir Control and Equip Rm
4385805	Arr of Equip - MK 86 Equip Rm
4385806	Sonar and Torpedo Countermeasures Systems
4385807	Arr of Equip - Sonar Equip Rm Nos. 1, 1A, 2 and 3
4385808	Antenna Arr
4385612	Arr of Equip - Air Navigation Equip Rm
4385783	Radio Communication System
4385784	Arr of Equip - Comm Ctr SUPRAD Rm, Xmtr Rm, and Emer Radio Rm

ELECTRONIC CONTRACT GUIDANCE DRAWING

4385794	Radar Antennas - Arcs of Coverage

ELECTRICAL CONTRACT GUIDANCE DRAWINGS

4385733	Schematic Diagram - Coolant Pump Power System
4385772	Electrical Power System Switchboards - Arrangements
4385773	Ships Service 400 Hz System Power Diagram
4385774	Control Units for Remote Control of Generators
4385775	Ship Service 60 Hz System Zone Power Diagram (Exclusive of Propulsion Plant)
4385776	Lighting System Diagram
4385777	Arrangement of Equipment - 400 Hz Motor Generator Rooms
4385785	60 Hz Electrical Power System Elementary Diagram-Propulsion Plant Zones
4385786	Ship Service and Emergency 60 Hz Power Diagram

9020-1-d. Correspondence and drawing forwarding procedure

The Contractor shall direct correspondence with NAVSHIPS or other Government activities concerning drawings via the Supervisor as specified in 5000-0, enclosing prints of the various types of drawings as outlined herein. Large shipments of Contractor drawings designated for delivery to a Government activity may be sent directly to that activity provided a copy of the forwarding letter and a list of the drawings sent are enclosed; however, the original forwarding letter shall be sent via the Supervisor.

~~Drawings or reproductions thereof, designated~~ for NAVSHIPS approval, or information and file, shall be addressed to: Commander, Naval Ship Systems Command, Washington, D.C. 20360.

Where practicable, correspondence regarding approval of drawings for transmittal to NAVSHIPS shall be limited to the coverage of a single subject corresponding with the categories listed in NAVSHIPS publication 0902-002-2000.

Correspondence forwarding drawings, and lists accompanying drawings forwarded separately from correspondence, shall list each drawing forwarded, indicating its title, drawing number, and latest revision letter. Drawing lists shall reference the forwarding letter.

Correspondence forwarding drawings for approval or other action shall be separate from correspondence forwarding drawings for information and file.

Prints forwarded to the Government shall be folded in accordion pleated form to a size not to exceed 8½ by 14 inches, with the title block clearly visible, except that copies of the Booklet of General Drawings shall be folded as shown on Mil. Std. MS 18267.

All drawings and reproductions shall be prepared for mailing or shipping in accordance with Mil. Spec. MIL-D-1000/2.

9020-1-e. Drafting and drawing reproduction requirements

Unless otherwise specified, hull, machinery, electrical, and electronics Contractor-furnished equipment drawings, parts lists, and material lists, shall comply with Mil. Spec. MIL-D-1000/2, form 2, categories A, B, D, G and H. Hull construction drawings shall comply with category E. In addition, electronics equipment and installation drawings, shall comply with Mil. Spec. MIL-D-23140.

In addition to the above, the following categories will also be required:

C - if special service test is intended.

E or I - if Government should buy design.

F - if drawing to portray form, fit, and function only, is needed for procurement.

J - if the contract explicitly identifies which parts are to be controlled.

~~Existing engineering drawings that can be modified~~ to meet the technical requirements ~~for the~~ form required, shall be altered, ~~reidentified~~, and supplied in lieu of ~~new drawings~~, if this procedure is more economical to ~~the Government~~. Drawings need not be redrawn to meet the ~~format or title block requirements~~.

NAVSHIPS drawing numbers shall be assigned to all type I (MIL-D-1000/2) drawings.

shall be installed for testing the automatic cutout valve. This connection shall discharge to the atmosphere so as not to endanger personnel. The size of the test connection shall be the same as that of the piping in which the automatic valve is installed. The test connection shall be so arranged that an orifice disc calibrated to give the maximum delivery of air required by the service, can be installed to test the automatic valve for normal functioning as well as to check the automatic shutoff feature.

9490-1-d. High pressure air system

General. - This system shall provide dry air at 3000 p.s.i.g. for charging air banks and, for supplying services as required and as specified herein. All high pressure air piping shall incorporate provisions to insure:

1. Minimization of lubricant deposited in piping, air flasks, and other components.
2. Easy inspection and cleaning of piping, air flasks, and other components.

Each branch from the high pressure air main to an air bank shall be provided with a cutout valve, a check valve allowing air to flow only into the bank, and a cutout valve, in that order. ~~A bypass with a locked close valve shall be installed around the first cutout valve and the check valve.~~

~~The high pressure air system shall be cross-connected with the ships service air system through a reducing valve(s) with bypass with the portion of the ships service air system associated with air operated propulsion plant valves and controls and propulsion machinery control by use of air flasks and reducing stations.~~

Air compressors and associated equipment. - Each high pressure air compressor shall discharge to the system via a moisture separator Mil. Spec. MIL-F-22606 and an air dryer. The moisture separator and the air dryer shall be as close as practicable to the compressor served. A check valve shall be provided downstream of the moisture separator. Valves shall not be installed in the piping between the compressor and the moisture separator.

The valve in the moisture separator drain line shall be in accordance with Mil. Spec. MIL-V-24109.

A ten cubic foot air flask shall be provided at each compressor downstream of the air dryer to serve the high pressure air system. These flasks shall not be provided with check valves and bypasses.

Each compressor shall be equipped with a device which will indicate actual compressor running time in hours.

The air dryer shall be in accordance with Mil. Spec. MIL-D-17847. Cut out valves shall be provided for each air dryer, and a by-pass with a locked close valve and a cartridge type air filter, capable of handling a rated flow equal to that handled by the normal air dryer for a minimum of four hours, while delivering 3000 psig air with a maximum ~~dewpoint~~ of minus 60° F. shall be provided around each air dryer to permit emergency air supply to the system in the event the air dryer has to be secured for repair.

Air banks. - Air banks shall be provided as required to serve the air requirements as specified in this section. Each air bank shall be provied with a pressure gage and each flask with a cutout valve to permit isolating a leaky flask or removing it for repair.

MK 32 torpedo tubes. - Outlets from the high pressure air system for charging the breech mechanism to 1500-2000 p.s.i.g. shall be installed in the vicinity of each MK 32 torpedo tube. Charging stations shall include a 50 micron nominal size filter and a throttle valve.

Throttle valves shall be in accordance with Mil. Spec. MIL-V-24109.

MK 26 GMLS. - A 1½ cubic foot air flask and a reducing manifold for charging the missile water injection system's fresh water accumulator tanks shall be provided. (See 9480-3 for pressure requirements.)

5"/54 gun gas ejection and counter-recoil systems. - ~~An air flask of 6 cubic foot capacity shall be provided for gas ejection.~~

The gas ejecting air supply from the air flask shall be designed for a flow rate of 2.5 s.c.f.s. at 175 p.s.i.g. Down stream of reducing station, the following fittings shall be installed in this order: Pressure gage, relay tank (fitted with hand hole) with locked open cutout valve floating on the line.

Air shall be tapped off the gas ejection line and reduced to 100 p.s.i. for emergency and maintenance operation of the train and elevating systems.

Outlets shall be provided for an emergency supply to charge the counter-recoil cylinders at 1920 p.s.i.g., upper and lower accumulators at 1000 p.s.i.g., and the servo accumulator at 125 p.s.i.g.

5

• Pneumatic System For Motor-Operated Valves. - Remotely controlled Air-motor operated valves in the engine rooms and auxiliary rooms shall be provided with 3000 p.s.i.g. air flasks for emergency operations. One flask shall be provided in each auxiliary room to serve the steam generator main steam cutout valves. The remaining air- motor operated valves in the enginerooms shall be provided with individual flasks, if widely separated, or one flask serving several valves in close proximity. Each flask shall have sufficient capacity for two closing cycles of each steam generator main steam cutout valve served, and one closing cycle of each of the other valves served, assuming that all valves served by any one flask close simultaneously. The flasks shall be supplied from the high pressure (3000 p.s.i.g.) air system and shall be arranged to supply air via a reducing station to the valve air motors when the ship service air system is inoperative or inadequate. Flask sizing shall be based on a flask air pressure corresponding to the compressor start-up pressure.

Reactor plant air system. - Supplies from the high pressure air system shall be provided to serve the reactor plant control air system and reactor plant ventilation control air system.

These connections and associated reducing stations shall be in accordance with 9890-1.

Sonar Dome. - Supply from the high pressure air system shall be provided for sonar dome emergency requirements. An air flask of 8 cubic feet capacity shall be provided. A pressure reducing station shall be provided to supply air ~~[illegible]~~ to the sonar dome system. This line shall be connected to the ship service supply line upstream of the manual pressure regulator in the control panel.

9490-1-e. Starting air systems for diesel engines

Starting air shall be provided from the high pressure air system and shall be stowed in starting air flasks at 3000 psig. The starting air flasks shall be sized to permit ten consecutive starts, including one cold start for the engine served. The starting air flasks shall be stowed in the same compartment as the engine.

Emergency diesel generators. - A reducing ~~valve with bypass~~ shall be installed downstream of the starting air flasks. The reducing valve shall be set at the required engine air starting pressure. The flask discharge shall be provided with a cutout valve, and automatic starting air valve actuated by one or two solenoid valves as necessary to operate in conjunction with equipment furnished in accordance with Mil. Spec. MIL-S-17773. The solenoid valves shall be arranged to open the automatic air starting valve on low voltage of the ships service supply to the emergency switchboard and to close on normal voltage. The common actuating line to the solenoid valves shall be provided with a filter.

To indicate when all manually operated valves are set up for automatic operation, all cutout valves, except the bypass valve around the reducing valve, shall be installed with a switch connected to a green indicator light on the switchboard, Mil. Spec. MIL-S-16036, indicating that the cutout valves are in the open position.

A control valve shall be installed in the compressed air starting system to preclude admission of starting air to the engine when the engine is running.

The air piping between the starting air flask and the diesel generator shall have sufficient flexibility to withstand vibrations resulting from normal operation of the unit and also from minor displacements due to battle damage.

9490-1-f. Ship service air system

General. - The ship service air system shall be designed to operate at a pressure of 125 p.s.i.g.

The low pressure compressed air packages shall be arranged to discharge to a common main.

The ship service air system shall consist of a vital servicemain and a non-vital service main.

The pressure drop from the low pressure compressed air packages to the most distant point served by the ship service air system shall not exceed 10 p.s.i. when air is flowing at the maximum rate demanded by the connected services at the designed conditions up to the total compressor capacity.

Compressor Package - Three ships service air compressor packages supplying oil-free compressed air shall be installed. Each air compressor package shall have a capacity of 200 SCFM when operating at a discharge pressure of 125 PSIG (measured at the connection to the ship's system) and at the design conditions specified in the applicable compressor specifications. When operating at the design conditions and at a discharge pressure of 80 PSIG the moisture content of the discharge air shall not exceed 0.0022 pounds per pound of air. The air compressor package shall be designed for continuous 24 hours a day duty under the specified design conditions.

Each air compressor package shall consist of one assembly, including refrigerated air dryer and accumulator, mounted on a common base ready for installation on a shipboard foundation.

The electric motor controller shall be provided for separate installation remote from the compressor package.

The air system of the compressor package shall consist of components arranged in the order of air flow as follows:

Suction inlet filter and silencer
Compressor (with inter and after-cooler if required)
Refrigerated dryer
Check valve
Accumulator
Shutoff valve
Discharge connection flange

The refrigeration type dryer shall be in accordance with the requirements of specification MIL-D-23523B and amendment 1 thereto for a type 1 unit, except as modified herein. The refrigerated dryer shall be fitted with a particulate after-filter in lieu of the oil and particulate removal filter. Controls, valves, instruction plates, gauges, thermometers, and gauge boards shall not duplicate those provided with the entire compressor package. The condensate removed by the dryer shall be blown off by the automatic compressor drain system or by other automatic means.

Need Next week

1. 2 copys of 732 DRWG

2. Need Brolin TVAR

3 Proposal for High pressure air And low pressure air cont valve

4. Sample page of 23 Dwg + Cont proposal (or something similar)

Cont #274

5. Two copies of contract Dwg on HP Air syst 15765

6 - Cont #274.

7. TWX's on R.P.T. Development prior to definitize

#14

FOR OFFICIAL USE ONLY CITAR 5.2.8

PRELIMINARY
CLAIM ITEM TECHNICAL ANALYSIS REPORT
NO. 5.2.8

APPLICABLE TO NEWPORT NEWS SHIPBUILDING
CONSOLIDATED CLAIM FOR EQUITABLE ADJUSTMENT
UNDER CONTRACT N00024-70-0252

CLAIM NO. 5.2.8
REACTOR COMPARTMENT VENTILATION
CONTROL AIR SYSTEM

FOR OFFICIAL USE ONLY

TABLE OF CONTENTS

Page

SECTION I CONTRACTOR'S CLAIM

A. General 1
B. Specific Elements of the Claim (Allegations) 2
C. Contractor's Basis for Entitlement 4
D. Amount Claimed (Quantum) 4

SECTION II FACTS

A. Relevant Provisions in the Contract/Ship's Specifications 5
B. Summary of Events, Facts and Correspondence 20

SECTION III ANALYSIS

A. Outline of Issues 30
B. Analysis 30
C. Summary/Conclusions 36

SECTION IV RECOMMENDED GOVERNMENT POSITION

A. Summary 37
B. Specific Recommendation 37

SECTION V REFERENCES 39

SECTION I - CONTRACTOR CLAIM

A. GENERAL

1. The reactor compartment ventilation control air system is a system of pipes and valves that controls the flow of compressed air from the ship's compressed air system to the individual pneumatic operators on the large butterfly valves in the reactor compartment ventilation system.

2. The Contractor represents that he was misled by the Ship's Specifications, allegedly vague contract guidance drawings, and the lack of other design data during the bid process. He states that he assumed for bid purposes that he would be building a simpler reactor compartment ventilation control air system similar to that in CGN 36 except for the high pressure portion of the system which he states he properly recognized as being more complex in CGN 38 than in CGN 36. He asserts that, subsequent to the contract definitization, continued Government actions and inactions precluded his recognition of the effort he would have to expend and added to this effort.

3. The Contractor, therefore, seeks an equitable adjustment in target cost of $989,216 plus profit, target-to-ceiling spread and escalation, as stated elsewhere in the claim, to compensate him for the alleged defective Government specifications and other Government actions and inaction He states in his cost estimating sheets the amount of requested target price increase to be the difference between his current estimates for the CGN 38 Control Air System and the CGN 36 system less an adjustment for HMR 145 (which has been negotiated to cover a change in the system from that shown on the contract guidance drawing) and less an adjustment for the amount he put in his CGN 38 "bid" for the high pressure portion of the system.

4. The Contractor also states that as of June 30, 1975:

> "The Contractor has not received a satisfactory set of working drawings for this system from the Government's Reactor Plant Lead Yard. A second preliminary request for additional funding is being prepared for submittal to the Government as in response to a Change Order based on the increased complexity of the system and lack of adequate Government furnished information. If a contract Change Order is received for this system, then the price estimate for this work will be excluded from this proposal. In any event, the Contractor reserves all rights to equitable adjustment in the areas of delay and disruption

that may result from problems associated with this system."

B. SPECIFIC ELEMENTS OF THE CLAIM (ALLEGATIONS)

1. Vague,Unclear Bid Information: The Contractor alleges:

a. Specification section 9890-1 states that the CGN 38 reactor plants will be similar to those in CGN 36. The Contractor states:

> "The Contractor had a right to assume, and did assume, that the reactor plant design for the DLGN 38 Class would be similar to that employed in the DLGN 36."

b. Although specification section 9890-1 provides also that the design will be in accordance with "Contract Guidance Plan① DLGN 38-800-4375731" (should be 4385731) and although this plan was available at the time of definitization of the contract by Modification P00007 effective 21 December 1971,

> "it could not be recognized that it [the contract guidance drawing] was so vague and misleading as to be deficient for either proposal or performance purposes. Specifically, with the exception of the high pressure (HP) air system these documents did not reveal the extent of any changes in the design of the DLGN 38 reactor plant ventilation control air system...."

2. Evolutionary and Changing Design Even After Contract Signed

The Contractor alleges that even after the Contract was signed, because of the evolutionary nature of the design and test procedures, he could not have recognized the extent of the system or identified the effort he would have to expend. He asserts that:

a. "The first meaningful indication of the extent of the change became evident in July 1973 when the diagram for the ventilation control

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[1] The title of this plan is "Diagram Reactor Compartment Ventilation Control Air System." It is reference (a) to this CIIAR.

air system (Electric Boat Plan 38643-01X01) was received." The Contractor notes Modification A00468 effective November 13, 1974, (HMR 145), was issued as a result of changes from the Contract Guidance Drawing indicated on the ventilation system diagram. He asserts, however, that he could not calculate pipe lengths from the diagram and "Consequently, as the result of the continuing deficient nature of the Government furnished design data, the original system estimate and the HMR 145 estimate did not include the required material and manhour requirements necessary for construction of this system as it was finally designed." The Contractor alleges that "Further indication that the system obviously had become much more comple than could reasonably have been anticipated became visible after receipt of the Government furnished control air piping working plans which became available on November 21, 1974, (Forward Plant) and October 1, 1974 (After Plant) but that: "Even after receipt of these plans, the full extent of the changes in the design requirements were unclear. The data contained therein were so incomplete and ambiguo as to preclude meaningful analysis."

b. The Contractor cites the furnishing of test procedures for the control air system after contract definitization as a further reason the Contractor could not have originally estimated his work scope. He cites his letter dated 19 November 1974 as indicating this problem and the NAVSEA letter in response dated 10 December 1974.[2] In the claim the Contractor says the following about the 10 December 1974 NAVSEA letter: It

> "stated an opinion that the Contractor had had adequate information in the contract guidance drawing available to foresee these requirements" and which statement "was made even though the Government was aware that no test procedures were available to the Contractor at the time the contract was definitized by Modification P00007 on December 21, 1971."

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[2] These letters are references (d) and (e) of this CITAR

3. Specific Problems With Design: The Contractor cites, in addition to the basic issue of the control air system allegedly not having been properly defined in the specifications, three examples of problems he alleges resulted in added work by the Contractor which was not contemplated at the time the contract was definitized. These problems include:

a. The Government design required a submersible pressure switch which the Contractor could not buy and, therefore, he had to design and build a watertight enclosure around the pressure switch resulting in added work.

b. Three Plan Revision Notices (A-747, A-743, A-742) which allegedly modified the Government's design allegedly causing disruption due to drawing revision.

c. Alleged difficulty in obtaining legible sepia prints from the Reactor Plant Lead Yard necessary to ensure proper construction of the system which is causing delay and disruption.

C. CONTRACTOR'S BASIS FOR ENTITLEMENT

The Contractor claims deficient Government furnished information misled him into believing he was contracting for a system that was simpler and less expensive than the one he was required to build and test. He, therefore, asserts that he is entitled to a contract adjustment. The Contractor also cites various facts and sets forth allegations of deficient or impossible Government furnished designs and Government actions or inactions that allegedly continued to mislead him as to the true cost so as to entitle him to reprice the contract based on a new estimated cost for the system.

D. AMOUNT CLAIMED (QUANTUM)

1. The summary of manhours, materials, and other costs claimed by the Contractor on this claim item is as follows: (This amount was computed by the Contractor as stated in Paragraph IA3, page 1, of this CITAR)

CLAIM

Ships	Production Hours	Engineering Hours	Material
CGN 38	23,177	10,300	65,483
CGN 39	23,177	1,700	33,418
CGN 40	23,177	1,700	33,418

SECTION II - RELEVANT FACTS

A. RELEVANT PROVISIONS IN THE CONTRACT/SHIP'S SPECIFICATIONS

1. Article 9.b Subsections (1) and (2) and (3) of the Special Provisions of the CGN-38 Class construction contract N00024-70-C-0252 effective 21 December 1971 state:

> "(b) Reactor Plant and Overall Propulsion Plant Control Systems
>
> "(1) One (1) reproducible copy of working drawings, technical manuals, and other design data for the reactor plant and overall propulsion plant control systems, as necessary to ensure proper installation shall be furnished by the Government to the Contractor for use under this contract. Data to be provided by the Government shall be:
>
> Working drawings covering the area described in 9890-1 of the Specification.*
>
> Technical manuals for GFE.
>
> Technical Specifications for CFE and materials as described in 9890-1 of the Specifications and on the drawings above.
>
> Other required design data.
>
> Test procedures for reactor plant and integrated propulsion plant testing as described in 9080-1 of the Specifications.*
>
> Reactor plant manual.
>
> "(2) Working drawings, technical manuals and other design data for the reactor plant and propulsion control systems listed in (b) (1) of this Article, which are being developed* for the DLGN38 Class Frigates shall be furnished to the Contractor as they become available and shall be used without deviation,* unless deviations are authorized by the Naval Ship Systems Command. It is intended that these drawings conform to the specifications.
> In the event that any drawing be found not to comply with the specifications, the Contractor shall refer the question to the Deputy

Commander of the Naval Ship Systems Command (SHIPS 08) for resolution prior to proceeding. In the event of any inconsistency between the specifications and the non-deviational drawings, or the specifications and other drawings, the specifications shall govern as set forth in Clause 2 of the General Provisions.

Specs take precedence over drawings (deviation & non deviation)

"(3) In addition to the working drawings, technical manuals and other design data furnished under paragraphs (b)(1) and (b)(2) of this Article, the Government will furnish such other design data and related services as are being developed under "Definition of Technical Liaison Responsibilities of the DLGN38 Class Reactor Plant Lead Yard" dated 24 December 1970 [changed to issue dated 18 April 1972 by MOD P00014] to the Contractor as they become available. Said design data and related services above mentioned will be provided under Naval Ship Systems Command contracts with General Dynamics Corporation, Electric Boat Division, Quincy."

The Nuclear — shorts in various drawings [illegible] not approved

2. Section 9890-1, "Propulsion: Nuclear Power", of the Ship's Specifications, sets forth specification requirements for reactor plant portions of the ship under the technical cognizance of NAVSEA 08 as follows:

a. Section 9890-1-a, "General", of the Ship's Specifications states in part:

"Two reactor plants similar to those provided in the DLGN36 Class shall be installed in accordance with working drawings, Component Technical Requirements (CTR's), Component Applicability List and Component Technical Specifications to be furnished by the Government."

Claim [illegible] [illegible] on this

b. Section 9890-1-b, "Scope of Government Furnished Drawings," of the Ship's Specifications states in part;

"The Government furnished working drawings will be based on the contract drawings and contract guidance drawings and will cover the following areas:

> (1) Reactor plant fluid systems as defined on contract guidance drawings DLGN38-800-4385710 through 800-4385731.
>
> (2) ...."

(Note: this listing thus includes Contract Guidance drawing 800-4385731 "Diagram Reactor Compartment Ventilation Control Air System")

3. Section 9020-1-b, of the Ship's Specifications states in part:

> "Contract guidance drawings are NAVSHIPS drawings forming part of the specifications and serve as an illustrative guide for developing working drawings."

4. Section 9080-1 of the Ship's Specifications states concerning the testing of reactor plant systems:

> "The following requirements apply with regard to reactor plant and integrated propulsion plant testing:
>
> (a) All testing shall be performed in accordance with test procedures and operating procedures furnished by NAVSHIPS and in accordance with NAVSHIPS 0989-026-5000; Manual for the Control of Testing and Plant Conditions...."

5. Section 9490 of the Ship's Specifications concerns compressed air systems. Section 9490-1-b states:

> "9490-1-b. Reactor Plant Systems Air
>
> The reactor plant control air system and the reactor compartment ventilation control air system shall be installed and tested * in accordance with drawings and test procedures provided under 9890-1 and 9080-1".

Relevant sections of section 9490-1-d High Pressure Air System state:

> "...Reactor Plant Air System - supplies from the high pressure air system shall be provided to serve the reactor plant control air system and reactor plant ventilation control air system. These connections and associated reducing stations

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* Emphasis added

shall be in accordance with 9890-1." — Which is another

this [illegible] the [illegible] drawn.

Comparable sections from the CGN-36/37 specifications do not mention a reactor ventilation control air system. These sections follow:[1]

[illegible] From the 36

"9490-1-b. Reactor Plant Control Air

> The reactor plant control air system shall be installed and tested in accordance with plans and test procedures provided under 9890-1 and 9080-1,"

and:

"9490-1-d High Pressure Air System ...

> Reactor Plant Control Air - Supply from the high pressure air system shall be provided to serve the reactor plant control air system. This connection and associated reducing stations shall be in accordance with 9890-1."

Thus, it can be seen from the above that the CGN-38 specifications were specifically changed from those in CGN-36 to call out the new reactor compartment ventilation control air system. These specification references to the ventilation control air system are in addition to the specific listing of the system in 9890-1-b as noted in Section II.A.2., p. 6, above).

6. Special Provisions of the Construction Contract N00024-70-C-0252 Article 1 titled "General Scope of Work" implemented by modification P00007 effective 21 December 1971 states:

> "(a) Introduction. Notwithstanding any provisions hereof to the contrary, all work authorized and/or performed, actions taken or deliveries made under the contract prior to the effective date of this Supplemental Agreement P00007 shall be considered to have been authorized hereunder; and, furthermore the parties do hereby agree that the target cost, target profit, target price and ceiling price as hereinafter set forth in Article 1 and that the delivery date for each and every vessel as set forth in Article 3, comprehends in full all equitable adjustments in whatsoever nature to which the Contractor or the Government would, or might, otherwise be entitled in respect of, arising from, or incidental to actions or failures to act on the part of the

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[1] The reader's attention is called to the fact, that the "reactor plant control air system "in both CGN-36 and CGN-38 is not the reactor compartment ventilation control air system. " The reactor plant control air system controls reactor plant components other than the ventilation valves and is a separate syste

> Contractor or the Government, their officers, agents or employees, which occurred on or before the date of the execution of this Supplemental Agreement P00007, and the parties hereby expressly for themselves, their successors, and assigns agree not to present to the Contracting Officer or to any agency of the Government, any claim, or to initiate any action or suit in any court, in respect thereto."

7. Article 29, "Changes", of the shipbuilding contract for CGN-38 Class states in part:

> "(a) The Contracting Officer may at any time, by written order, designated or indicated to be a Change Order, and without notice to the sureties, make changes, within the general scope of this contract, in any one or more of the following: (i) drawings, designs or specifications; (ii) methods of shipment or packing; and (iii) place of delivery.
>
> "(b) If the Contractor considers that any other written or oral communication, including any order, direction, instruction, interpretation, or determination, received from a representative of the Government, or that any other action or omission of the Government, constitutes a change order, the Contractor shall so advise the Contracting Officer in writing within ten (10) days, and shall request his written confirmation thereof. Except as provided and circumscribed in paragraph (h) below, the Contractor shall take no action thereunder until he has been advised by the Contracting Officer in writing as to the disposition thereof...and if the Contractor complies with any order, direction, interpretation, or determination, written or oral, from someone other than the Contracting Officer, without providing the notice and receiving the response provided above, it shall be at the Contractor's risk, and the Government shall not be liable for any increased costs, delay in performance, or Contract nonconformance by the Contractor...".
>
> "(c) Except as herein provided, no order, statement, or conduct of any representative of the Government shall be treated as a change order under this clause or entitle the Contractor to an equitable adjustment hereunder.

"(d) If any change under this clause causes an increase or decrease in the Contractor's cost of, or the time required for the performance of any part of the work under this contract, whether changed or not changed by such order, an equitable adjustment will be made:

(i) in the contract price or delivery schedule or both, and

(ii) in such other provisions of the contract as may be so affected

and the contract shall be modified in writing accordingly: Provided, however, that except for claims based on drawings, designs, or specifications which are allegedly defective or impossible of performance, no claim for any change under (b) above shall be allowed for any costs incurred more than twenty (20) days before the Contractor gives written notice as therein required; and Provided, further, that in the case of drawings, designs, or specifications which are defective or impossible of performance for which the Government is responsible, the equitable adjustment shall include any increased cost and delay reasonably incurred by the Contractor in attempting to comply with such defective or impossible drawings, designs, or specifications before the Contractor discovers or reasonably should have discovered the defectiveness or impossibility.

"(e) Any claim by the Contractor for adjustment under this clause must be asserted within 30 days from the date of receipt by the Contractor of a written change notice under (a) above or the furnishing of a written notice under (b) above; provided, however, that the Contracting Officer if he decides the facts justify such action, may receive and act upon any claim asserted at any time prior to final payment under this contract. Where the cost of property made obsolete or excess as a result of a change is included in the Contractor's claim for adjustment, the Contracting Officer shall have the right to prescribe the manner of disposition of such property.

> "(f) Failure to agree to any adjustment shall be a dispute concerning a question of fact within the meaning of the clause of this contract entitled Disputes. However, nothing in this clause shall excuse the Contractor from proceeding with the contract as changed as herein provided."

The "Changes" provision of the contract is intended to permit the Government to make changes to the contract as and when necessary to ensure the orderly construction of the ship. The clause likewise affords the Contractor an ample opportunity to submit a claim for an equitable adjustment to the contract pricing and delivery provisions where he deems such action justified. Such a claim must be asserted within 30 days from the date of receipt of the notification of change. Further, this clause provides that in the case of changes issued by a representative of the Government, the Contractor must so advise the Contracting Officer within 10 days, and that in cases of changes issued by someone other than the Contracting Officer, failure to so advise the Contracting Officer releases the Government of liability for increased costs, delay and/or contract nonperformance for which the contractor, in view of his failure to provide the required notice, must then assume all risk.

Moreover, this clause provides that except for costs associated with impossible or defective specifications, no claim will be allowed for costs incurred more than 20 days before the Contractor has notified the Contracting Officer in writing of any Government action or omission which the Contractor considers to constitute a change.

It is further noted that the Changes Clause defines Contracting Officer as "the term 'Contracting Officer' shall be as defined in the clause of this contract entitled 'Definitions' except that the term shall not include any representative of the Contracting Officer whether or not such representative is acting within the scope of his authority."

The President of Newport News recognized this obligation to notify the Government and obtain specific Contracting Officer authorization prior to performing any work considered out of scope and so notified Division and Department heads in a Memorandum dated March 1, 1973, which stated:

> "All of the subject contracts provide, in one or more provisions, that we notify the Government and obtain its concurrence before performing the additional work. Therefore, if we perform work which is not required by the terms of a specific direction or concurrence to do so, in writing by a designated Contracting Officer, we can be held responsible for that work and not receive an adjustment in price for its accomplishment.
>
> "Therefore, work which is not clearly specified shall not be accomplished under any Navy ship construction or overhaul contract unless authorized in writing by a Contracting Officer, or the responsibility for the work has been determined to be within the scope of the contract by an authorized Company representative."

The Memorandum concluded by directing that the contents "be promulgated to each person under your cognizance who is in a decision-making capacity in the areas covered herein."

As will be shown in the analysis section of this CITAR and by additional facts later in this section of the CITAR, the contractor failed to provide the proper and timely notice to the Contracting Officer required by this article.

8. Article 31, "Problem Identification Reports", of the Contract states in part:

> "(a) Whenever the Contractor knows of or reasonably can anticipate the occurrence of any 'contract problem', which term as used therein means a fact or circumstance which can or will significantly or substantially alter the time of delivery or completion of performance or can give rise to a substantial claim for increased compensation or for modification of the contract or specification requirements, but excluding any claim for which notice is required by the clause of this contract entitled "Changes", the Contractor shall promptly transmit to the Procuring Contracting Officer (PCO), via the Administrative Contracting Officer (ACO), a "Problem Identification Report".

The parties agree that the meaning of such words as 'significantly', 'substantially', 'substantial', and the like as used in this paragraph shall be interpreted in the same manner as they would be interpreted by a reasonably prudent businessman under all the relevant circumstances.

"(b) Each Problem Identification Report required by this clause shall be entitled 'PROBLEM IDENTIFICATION REPORT', and shall be dated and numbered sequentially, and set forth, on the basis of the best information then known to the Contractor:

(1) The nature of the reported contract problem;

(2) The date the contract problem occurred or was discovered;

(3) The direct and foreseeable consequential ('ripple') effects of the contract problem upon the contracted cost of performance and delivery of supplies or services, identifying which supplies or services are or will be affected; and

(4) The contractor's recommended solution to the reported contract problem;

and shall be signed by a representative of the Contractor.

"(c) Notwithstanding the 'Changes' Clause of this contract, except for possible claims based upon defective specifications, the Contractor shall not be entitled, because of the occurrence of a contract problem, to any equitable adjustment of the target price and target cost due to the incurrence of costs therefore more than 20 days before the Contractor submits the required Problem Identification Report. Further, required Government actions performed prior to the date of a Problem Identification Report identifying such required Government actions shall be deemed to have been timely performed."

Thus, the parties to this contract agreed that the Contractor was required to provide Problem Identification Reports as set forth in the above Article.

The purpose of this clause is to provide visibility to the Government where any actions or inactions by the

Government or its Design Agents could impact the Contractor's ability to meet his contractual requirements. With such notice, the Government could then proceed to implement corrective action.

As will be shown in the Analysis section of this CITAR, the Contractor did not submit the required Problem Identification Reports on this matter which the Contractor now alleges had significant impact on his work and entitles him to a substantial claim for increased compensation. It is true that the Contractor did submit PIR#0015 (See Section II.B. 5 , page 22 following) concerning the required prompt receipt of the non-deviation system diagram for the ventilation control air system (one of the "working drawings" to be furnished). However, this PIR does not concern the basic issue he raises in this claim, that the control air system itself was not originally required under the contract as definitized in MOD P00007.

9. The procedures for liaison between the Government's Reactor Plant Lead Yard (EB-Quincy) and the shipbuilder are set forth in the document entitled "Definition of Technical Liaison Responsibilities of the DLGN-38 Class Reactor Plant Lead Yard." The technical responsibilities and the contractual environment in which these responsibilities are discharged is set forth in this document which is invoked by contract in Article 9 of subparagraph (b)(3) as quoted in item 1 above. That the Reactor Plant Lead Yard does not have authority to modify Government contracts with the shipyard was clearly stated in Section 1 of the "liaison responsibilities document" as follows:

> "I. GENERAL
>
> "This document describes the services to be provided by the Reactor Plant Lead Yard to the Shipbuilder for the building of a DLGN38 Class reactor plant and overall propulsion plant control system. It also contains the procedures for liaison and exchange of information between the Shipbuilder and the Reactor Plant Lead Yard. The establishment of these procedures does not in any way relieve the Reactor Plant Lead Yard or shipbuilder of their responsibilities to meet contract requirements.
>
> "The Reactor Plant Lead Yard does not have the authority to issue to the Shipbuilder any design data, technical documents or revisions thereto

> that are not within the scope of the applicable shipbuilding contract or which could result in a change in contract delivery or completion dates or in the negotiated price or amount of any contract. Correspondence from the Reactor Plant Lead Yard to the Shipbuilder will proceed on that basis and this understanding will be reflected in appropriate statements in the correspondence."

These procedures were established so that actions by the Lead Yard if considered by the shipbuilder to require a contract change would be referred to the proper contracting officer. These procedures, although formally invoked in the contract through the "liaison responsibilities document" were established and implemented as a way of doing business prior to P00007. The following paragraphs of this section contain background history on the limitations placed on the contractor and RPLY communications.

To avoid misunderstandings concerning the contractual status of the considerable day-to-day exchange of technical correspondence and other technical documentation concerning the nuclear plant exchanged between shipbuilders and the Government or its design agents, NAVSEA, in reference (m), requested that each such technical document from the Contractor contain a statement concerning the cost and delivery impact of that correspondence. Reference (m) also requested that if the cost or delivery date of a contract would be affected by approval of the action recommended by the correspondence an estimate of that impact be forwarded to NAVSEA 08. The letter also requested that if no change in cost or delivery would result from approval of the recommended action, the following be included with the correspondence:

> "The work that would result from approval of this submittal is within the scope of the contract(s) (Insert appropriate contract numbers) and no change in the contract delivery or completion date or the current negotiated price or amount of any Government contract with (Insert name of shipbuilder) is required."

The President of Newport News, via reference (n) stated that Newport News would place the requested actions into effect with the exception that in some cases during early stages of construction or involving large quantities of technical information, up to 45 days might be required to notify the Government of the need for a contract modification.

To further ensure that the contractual status of requested or proposed technical data or changes thereto continued to be recognized and understood. the Reactor Plant Contractor and the Reactor Plant Lead Yard were requested to include a statement similar to the following with all design data, technical documents and revisions forwarded to the Contractor.

> "(Insert name of originator) does not have the authority to modify contracts between the shipbuilder and the Government. Therefore, if the action contained herein is considered by the shipbuilder to require a change in the currently negotiated price or amount or delivery or completion date of any contract, the shipbuilder shall not proceed with the action contained herein but should promptly and in any event within 20 days of receipt of this document notify NAVSEA (08) in writing via the Supervisor of Shipbuilding of the facts and the reasons for considering that a contract change is required."

The statement utilized by the CGN38 Reactor Plant Lead Yard (RPLY) on technical correspondence complies with the above format.

10. The fact that the shipbuilder has a responsibility to provide technical information and design data to the RPLY during drawing development such that the RPLY's non-deviation reactor plant design drawings and the Contractor's ship design can be developed in a mutually compatible manner was recognized and specifically acknowledged by the Ship's Specifications and the liaison responsibilities document cited in Article 9 b (3) of the contract. This interaction is particularly necessary for the ventilation control air system since the pipes and components in this system must be attached to or routed around ship's structure and bulkheads that are under the shipbuilder's, not the RPLY's design cognizance.

The preparation of the RPLY's non-deviation working drawings are dependent on information and data provided to the RPLY by the Contractor covering items such as space restrictions, interferences, configuration and end connections of Contractor furnished components. The requirement in the Ship's Specifications that data be provided to the RPLY by the Contractor is set forth in Section 9890-1-d, "Requirements for Contractor Review and Information," of the Ship's Specifications which states in part:

> "The Contractor shall be responsible for reviewing the Government-furnished reactor plant

> working drawings, component Technical Specifications, Component Technical Requirements and the Component Applicability List and informing NAVSHIPS 08 or its designated representative of any areas where the ship design, construction or operation cannot be made compatible with them."
>
> "The Contractor shall provide, to the Reactor Plant Lead Yard, wiring diagrams for Contractor furnished reactor plant electrical equipment and dimensioned outline drawings (including weight, center of gravity and method of mounting) of all Contractor furnished equipment specified on the reactor plant working drawings."
>
> "The Contractor shall provide to the Reactor Plant Contractor wiring diagrams and information on the operating charactersitics of contractor furnished reactor plant equipment. This information shall be provided within 90 days following release for manufacture of any such equipment."

In addition to the requirements in the Ship's Specifications quoted immediately above, the liaison responsibilities document invoked by Article 9 of the contract sets forth the procedures for carrying out the routine and expected intercourse between the shipbuilder and RPLY during the non-deviation design development by both the Contractor and RPLY.

Applicable sections of the liaison responsibilities document; which concern drawing development and interchange of information are Sections III.B. and C which state:

> "B. Resolution of Interferences, Discrepancies and Lack of Information
>
> The Reactor Plant Lead Yard will take action to resolve requests made by the Shipbuilder via the Liaison Action Request (LAR) procedure (See Section IV) concerning interferences, discrepancies and lack of information identified during the construction of the DLGN38 Class reactor plants.
>
> "C. Shipbuilder Proposed Departures
>
> The Reactor Plant Lead Yard will review and take necessary action on departures from the

> Government furnished non-deviation reactor plant documents as proposed by the Shipbuilder via the LAR procedure. Where the LAR involves a change for the Shipbuilder's convenience or is required because of a deviation in Shipbuilder furnished information or material, the Shipbuilder will be responsible for engineering efforts such as clearing interferences, arrangement studies and any calculations including preliminary thermal stress analyses required to support these proposed departures. The Reactor Plant Lead Yard will perform the final thermal stress analysis and/or the shock analysis for Shipbuilder proposed departures from the non-deviation reactor plant documents as part of the LAR procedure. The final revision of the Government furnished drawings and technical specifications issued by the Reactor Plant Lead Yard will include all accepted departures and alterations unless the applicable LAR reply indicates the drawings and technical specifications affected will not be changed."

The applicable section of the liaison responsibilities document that concerns the shipbuilder providing data on shipbuilder procured equipment is section V.A. which states:

> "V. Shipbuilder Furnished Information
>
> A. Information on Shipbuilder Furnished Reactor Plant Equipment
>
> In accordance with Section 9890-1 of the DLGN38 Class Ship Specifications, the Shipbuilder will provide to the Reactor Plant Lead Yard via the LAR procedure, wiring diagrams for Shipbuilder furnished electrical equipment and dimensioned outline drawings (including weight, center of gravity and method of mounting) of all Shipbuilder furnished equipment specified on the reactor plant non-deviation drawings. ✓ Any changes required to the reactor plant non-deviation drawings to accommodate this equipment will be specifically identified

and substantiated with supporting information as defined in II.C. with the submittal of the wiring diagrams and outline drawings to the Reactor Plant Lead Yard. This information shall be submitted to the Reactor Plant Lead Yard as soon as possible but in any event, no later than 30 days prior to the scheduled release for manufacture. The information may be either approved vendor drawings or preliminary vendor drawings. If preliminary vendor drawings are submitted the Shipbuilder shall also provide his review comments and an identification of any uncertainties. The Reactor Plant Lead Yard shall be promptly notified of any equipment changes from that shown by information originally provided. Reactor Plant Lead Yard reply will not be required prior to Shipbuilder release for manufacture."

B. SUMMARY OF EVENTS, FACTS AND CORRESPONDENCE

1. Contract guidance drawing 800-4385731, "Diagram Reactor Compartment Ventilation Control Air System", ref (a) was issued in November 1969. The Contractor in the claim states he considered this system "would be a small non-nuclear system". However, the fact is that this system was identified as a nuclear system in the same manner that all other nuclear systems were identified, as discussed below. The drawing title block shows that the drawing was prepared by the Reactor Plant Lead Yard (EB-Quincy). The Navy approval signature in the title block included the words "Naval Ship Systems Command-08" which identifies that the signer was a representative of NAVSHIPS (now NAVSEA) 08 which is cognizant over the reactor plant. Section 9890-1 of the ship's specifications lists this drawing as a nuclear drawing (See Section II.A.2 on page 7 , above) and the title of the drawing is "Reactor Compartment Ventilation Control Air System". The contract guidance drawing presented a detailed diagram of the system. It identified by size, type, pressure rating, specification material and procurement responsibility (i.e. government or contractor) each and every: valve, gage, pressure switch, air flask, test connection, and reducing manifold. It showed how the system controls the pneumatic operators on each of the fourteen (14) reactor compartment ventilation butterfly valves. The drawing showed each and every piping interconnection between components even indicating pipe size. The contents of this drawing disprove the Contractor's allegations that the drawing "was so vague and misleading so as to be deficient" for proposal purposes and that it failed to indicate the extent of the system. The Contract Guidance drawing is not a construction working drawing, but review of the specification and contract wording shows that it was not intended to be and neither party expected the "working drawings" would be prepared before contract signing.

2. The following facts comparing the CGN-36 and CGN-38 contradict the Contractor's assertion that he had grounds to expect that the Reactor Compartment Ventilation Control Air System in CGN-38 would be similar to that in CGN-36.

a) Comparison of specification sections 9490 as discussed in Section II.A.5 page 7 , above, shows that the CGN-38 specifications were changed from those for CGN-36 to include in section 9490 reference to the new ventilation control air system.

b) In CGN-36, unlike CGN-38, there was no reactor compartment ventilation control air system contract guidance drawing. In CGN-36 the controls for the reactor ventilation system butterfly valves were shown by a sketch on the contract guidance drawing for the reactor compartment ventilation system. In CGN-38 however, a separate nuclear system called the Reactor Compartment Ventilation Control Air System was shown on a separate contract guidance drawing that was specifically listed in section 9890-1 along with the other nuclear system contract guidance drawings. Furthermore, the CGN-38 reactor compartment ventilation system contract guidance drawing references the CGN38 reactor compartment ventilation control air system guidance drawing for the design of the control system in lieu of having a sketch of the system as is done for the less complex system specified for CGN-36.

c) In CGN-36 there are five (5) reactor compartment ventilation valves for each reactor. The five valves, each with a pneumatic operator, were shown on the CGN-36 reactor compartment ventilation system contract guidance drawing. In CGN-38 there are fourteen (14) butterfly valves as a result of different design requirements. Each valve was shown on the CGN38 reactor compartment ventilation system contract guidance drawing as well as on the reactor compartment ventilation control air system contract guidance drawing. The Contractor recognized in his bid proposal that he had to provide a ventilation system with the 14 valves, almost 3 times as many (14 vs 5) as in CGN-36. Yet, he argues, despite the contract guidance drawings and specifications, that he had a right to expect the control air system to be no more extensive than that in CGN-36.

3. Contract Modification P00002 authorized the Contractor to conduct all procurement, planning, scheduling and design work for the reactor plant and overall propulsion plant control systems. This contract modification was negotiated September 16, 1970, on a cost plus fixed fee basis more than 15 months prior to contract definitization on December 21, 1971. As the Contract guidance drawing was approved in November, 1969, it was available to the Contractor for the full 15 months period during which the Contractor was being paid by the Government to resolve procurement, planning, scheduling and design problems on a cost plus basis. The contractor furthermore had the contract guidance drawings showing the control air system two years before contract definitization (P00007) effective 21 December 1971.

4. Effective 21 December 1971, modification P00007 was signed defining the contract by establishing a delivery date, target price, target profit, incentive fee share arrangement, ceiling price and other provisions. Modification P00007 incorporated the "release language" cited in paragraph II A6 and the other provisions also cited in the paragraphs of section II.A., pages 5-19.

5. On May 30, 1972, Newport News submitted Problem Identification Report number DLGN-38-0015 stating that the control air system diagram, a non-deviation working drawing, was overdue "and urgently needed to support our Newport New's drawing schedule and material ordering schedule." Newport News alleged "performance is being seriously affected and a delay in scheduled receipt of material is probable." Newport News recommended that "every effort should be made to expedite 'Diagram-Reactor Compartment Ventilation Control Air System' (EB Drawing No. 38643-01X01) from Reactor Plant Lead Yard". (No evidence has been presented that in fact contract performance was adversely affected.)

6. On June 5, 1972, the requested "Diagram-Reactor Compartment Ventilation Control Air System" (EB Drawing No. 38643-01X01 NAVSHIPS No. 245-444-5028), reference (b), was issued. This diagram showed by size, type, pressure rating, each and every: valve, gage, pressure switch, air flask, test connection, and reducing manifold. It showed how the control air system controls the pneumatic operators on the 14 individual reactor compartment ventilation butterfly valves. The drawing showed each and every piping interconnection between components. In agreement with section 9890-1 of the Ship's Specifications, this working drawing was based on the information that was on the contract guidance drawing for the system.

This drawing, however, unlike the contract guidance drawing contained the non-deviation requirements because it is a "working drawing" as stated in the contract and section 9890-1 of the Ship's Specifications. It also included system details such as additional ordering data, component location, fabrication notes and the like which were of a greater level of detail than those normally found in the necessarily more general contract guidance drawing. This drawing when issued had several reservations, none of which affected the overall "scope" of the design. Specifically, these reservations were:

a. NAVSHIPS Drawing Numbers, as yet unassigned, for two references.

b. Range and location of Government furnished radiation detectors to be installed by shipbuilder but which do not connect to any of the system piping.

c. Periodic air testing requirements for system.

d. Pipe interconnection sizes pending pressure drop calculations (which were dependent on data to be furnished by the shipbuilder for shipbuilder furnished components).

e. Pipe sizes, reducing manifold capacity and relief valve set pressure. These values are dependent on data to be provided by the shipbuilder on shipbuilder furnished components.

As can be seen from the above and also as is more clearly shown by review of the drawing itself, reference (b), the system diagram in June 1972 clearly and explicitly showed the Contractor details of the system. Regardless of the detail shown on the contract guidance drawing issued in 1969 (which as shown before was fully adequate to show the extent of the system), there should be no doubt that the Contractor, in June 1972 after receipt of the reference (b) drawing which he had stated was urgently needed to enable him to order the system components, must have been fully aware of the extent of the system that he was required to build. This is contrary to the statement in the claim that the "first meaningful indication" of the extent of the changes in this system compared to the DLGN36 was not evident until a year later when he received Revision B of this drawing.

7. In June 1973 Revision B to the system diagram, reference (b), was issued. Revision B incorporated minor design developments, removed a reservation, and made one major change; it added a high pressure air reducing station that had not been previously shown on the contract guidance drawing.

8. Newport News reviewed this drawing revision B against the contract guidance drawing and by TWX 107 dated 30 August 1975 (ref (c)) stated:

> "1. Newport News review of (EB Dwg. 38643-01X01) reveals materials specified which are not on (contract guidance drawing 800-4385731).
>
> "2. Newport News considers the additional material on (EB Dwg. 38643-01X01) will involve work beyond the scope of contract N00024-70-C-0252.
>
> "3. Newport News is preparing an order-of-magnitude estimate of the additional cost and will inform NAVSHIPS by separate communication.

The additional material Newport News was citing was the high pressure air reducing stations that had been added by revision B, as is evidenced by the subsequent cost estimate and change issued (HMR-145) to cover this added work. Thus it is very clear that Newport News had reviewed the contract guidance drawing and had considered it sufficiently detailed to request a change based on the addition of various 1/4 inch valves, air flask, and pressure gages not shown on the contract guidance drawing. It should be noted that the Contractor's claim now requests payment for buying and installing many valves, flasks and miscellaneous components that were on the contract guidance drawing and the system diagram which he apparently accepted as being within the scope of the contract when he reviewed the revision B of the system diagram against the contract guidance drawing in mid 1973.

9. Newport News TWX 164 dated 29 May 1974 provided an order of magnitude cost estimate for this work. This cost estimate was superceded by Newport News TWX 115 dated August 30, 1974, which provided order-of-magnitude cost estimates for the control air system change as well as for items in other systems that had been previously identified by Newport News and NAVSEA as requiring contract changes. On 26 September 1974, NAVSEA issued HMR 145 to authorize the SUPSHIP Contracting Officer to negotiate a contract modification to implement the desired changes including the changes Newport News had identified between the system diagram and the contract guidance drawing of the control air system. The relevant language of HMR 145 which described the work scope is:

> "Provide additional air reducing stations in the reactor compartment ventilation control air system not shown on the contract guidance drawing but required for system operation."

On 14 November 1974, in contract modification A00468 Newport News and the SUPSHIP Contracting Officer executed a bilateral agreement incorporating the changes of HMR 145, which included the above cited change to the ventilation control air system. The language of modification A00468 provides that all the work of HMR 145 will be accomplished at target price and ceiling price change not to exceed $110,000 and that the delivery schedule remains unchanged. (The modification provisionally adjusted the contract ceiling price by $110,000).

10. On about 1 October 1974 and 21 November 1974 as stated by the contractor in his claim, the detailed installation working drawings for the control air system for each reactor plant were provided to the contractor. These drawings detailed the exact installation including dimensions for piping. It should be noted that these drawings showed the detailed routing of pipe around shipbuilder designed structure. These drawings also showed details for mounting the control air system components, most of which were shipbuilder furnished and mounted to shipbuilder designed structure. These detailed drawings could not have been developed until information on the shipbuilder's components and structure had been received from the shipbuilder to enable the RPLY to work out a satisfactory design in conjunction with the shipbuilder. It is noted that these drawings were to be provided "as they become available" in accordance with the terms of the contract. The drawings were provided as early as receipt of satisfactory shipbuilder information reasonably allowed.

11. Newport News' letter, serial DRPD 2681/15 dated November 19, 1974, to NAVSEA 08 via SUPSHIP ref (d)) stated with respect to testing of the control air system that:

a. Newport News has reviewed a Government furnished test procedure for hydrostatically testing the control air system and notes that all referenced or expected operational testing has yet to be specified.

b. "Newport News requests NAVSEA 08 supply Newport News with the scope of testing" to be performed "by December 16, 1974." Newport News needs this information for construction and test planning and the identification of test equipment.

c. "Testing and test equipment for the DLGN38 Reactor Compartment Ventilation Control Air System was assumed to be the same as the DLGN36 Class testing requirements of the comparable system. From the volume of the testing identified in the cited Government furnished hydrostatic

> test procedure and the quantity of the known required test equipment plus the still unknown additional operational testing Newport News considers this testing to be an increase in the DLGN38 Acceptance Test Program."

12. NAVSEA letter Ser 08J-8411 dated 10 December 1974, ref (e), responded, in part, that:

> a. The test procedure for the ventilation and ventilation control air system, which had been previously identified in the index of test procedures, was in approval review and expected to be issued no later than January 1975. The testing of these systems must be completed prior to initial criticality (criticality subsequently took place in June 1976). "The changes to this test procedure (covering both the ventilation system and the ventilation control air system) from that used for DLGN 36/37 are concerned only with operational test of new design features used in the DLGN 38 Class."
>
> b. "The design requirements for the DLGN38 Class Reactor Compartment Ventilation System and Reactor Compartment Ventilation Control Air System are clearly specified by the contract guidance drawings. These requirements are clearly different than for DLGN36/37, and thus, the testing requirements will also be different because of a need to test new design features. The Newport News assumption that the scope of testing and test equipment required would be the same as previously required for DLGN36/37 is thus an incorrect assumption. The Government cannot assume responsibility for such an incorrect assumption being made since adequate information was provided to Newport News. Therefore, NAVSEA does not agree with Newport News that testing of the DLGN38 Reactor Compartment Ventilation and Ventilation Control Air Systems, which is in excess of or different than that performed on DLGN36/37, is outside the scope of the DLGN38 acceptance test program.
>
> c. "Based on the discussion in (item b) above this letter concerns matters within the scope of Contract N00024-70-C-0252 and no change in contract delivery or completion date or in the current negotiated price or amount of any Government contract is authorized."

No response from the Contractor was received. The Contractor proceeded with the testing in accordance with the furnished procedures.

13. Facts relative to cited PRN's:

a. PRN's A-742 and A-743 were issued by the RPLY on 29 April 1975 against the detailed working drawings for fabricating the control air system piping. The PRN's state as their reason for issue:

> "Reason: to release Reservation #3 and complete plan work upon receipt of valve vendors information from NNSD."

Reservation #3 on the drawing had reserved the details for connection of the piping to the contractor furnished ventilation valves since the details were dependent on the detailed design of the ventilation valves that were furnished by the Contractor.

b. PRN A-747 was issued on May 1, 1975, which released a temporary holdup that had been issued 18 April 1975 when the RPLY discovered a design foul. This foul was discovered by the RPLY before the Contractor had fabricated the pipe as evidenced by the lack of an LAR or change notice from the Contractor. PRN A-747 provided the correct design that should have initially been shown on the drawing.

14. Facts relative to submersible pressure switch and transmitters:

a. Newport News LAR 776 dated July 6, 1973 and LAR 776 Supplement 1 dated August 1, 1973 ref (f) stated that pressure switches could not be obtained by Newport News that met all the requirements for the ventilation control air system pressure switches including pressure rating and submersibility. The LAR requested that the RPLY either identify a manufacturer of a suitable pressure switch or that a switch in a pressure tight container be permitted. The LAR stated "The work that would result from approval of this submittal is within the scope of Contract N00024-70-C-0252 and no change in contract delivery or completion date or the current negotiated price or amount of any Government contract with Newport News Shipbuilding and Dry Dock Company is required."

b. Subsequent review by the RPLY and reactor plant contractor showed that a pressure switch similar to that used in CVAN68 could be used, provided it was located on the side of a shipbuilder furnished watertight bulkhead not subject to flooding. By locating the switch on the side of the bulkhead not subject to flooding, the switch did not have to be submersible, but it did have to be mounted so that it was protected and its air lines passed through the bulkhead.

c. By letter dated 21 March 1974, ref (g) the RPLY requested Contractor concurrence to locate the switches in an enclosureon the watertight bulkhead in reactor plant #2 since such an enclosure would be part of the shipbuilder's non-reactor plant bulkhead. By letter dated 12 April 1974, ref (h), the Contractor concurred with one of the RPLY's proposed locations. By similar correspondence from the RPLY dated 22 July 1974 and from the Contractor dated 29 August 1974, the RPLY proposed and the Contractor concurred in the locations for the enclosure in the #1 reactor plant.

d. Plan Revision Notice P-55 dated 2 July 1974 was issued to specify the suitable pressure switch and its location in an enclosure on the opposite side of the bulkhead from the potential flooding. PRN P-55,reference (k) states "Electric Boat Division, Quincy, does not have the authority to modify contracts between the shipbuilder and the Government. Therefore, if the action contained herein is considered by the shipbuilder to require a change in the currently negotiated price or amount or delivery or completion date of any contract, the shipbuilder shall not proceed with the action contained herein but should promptly, and in any event within 20 days of receipt of this document, notify NAVSEA (08) via the Supervisor of Shipbuilding, of the facts and reasons for considering that a contract change is required."

e. No notice prior to this claim was received that indicates this correspondence and the actions taken thereby required a change in contract or were anything but the routine interchange required by the shipbuilding contract to accomplish the development of a satisfactory design.

16. Facts relating to alleged inability of the Contractor to obtain legible sepia prints "that is causing delay and disruption."

a. The Contractor cites no specific documents. Review of the prints of the non-deviation working drawings provided by the RPLY shows them to be legible. These drawings were provided using the same drawing room practices and equipment used for other reactor plant working drawings. It is noted that for drawings with necessarily close markings, the RPLY, if requested by the Contractor, would use contrast enhancement techniques ("mylar prints") on some drawings or portions of drawings. Such may have been the case for selected portions of the RPLY construction drawings, but there is no correspondence in which the Contractor identified legibility of the control air system as preventing him from fabricating the control air system.

b. It is noted that the Contractor made allegations to cognizant technical personnel (not the Contracting Officer) that the RPLY was delinquent in providing the reservation free non-deviation drawings, for the control air system. By letter dated 6 January 1975, reference (1), the RPLY pointed out that release of many of the holdups the Contractor was citing depended on the Contractor's first providing information on shipbuilder procured components. There is no record of a Contractor response to the reference (1) RPLY letter.

SECTION III - ANALYSIS

A. Outline of Issues

The Contractor alleges that he is entitled to a contract change for building and testing the reactor compartment ventilation control air system as specified in the non-deviation working drawings and test procedures furnished by the Government. To address the various allegations made by the Contractor, the following issues will be addressed:

1. Regardless of other issues, did the Contractor comply with contractually prescribed provisions for seeking reimbursement for the alleged added work?

2. What were the Contractor's obligations under the contract?

3. Were the contract specifications (including contract guidance drawings) deficient?

4. Was the evolution of the design such that it involved extra-contractual work and also excused the Contractor from having to provide the required timely contractual notifications of a claim.

5. Is the Government responsible for issuing a contract modification as a result of the three additional "problems" the Contractor cited?

B. Analysis

1. Contractual Notice Provisions. Article 29, "Changes" of the Contract Special Provisions requires, in part, that the Contractor notify the Contracting Officer within 10 days of actions considered to constitute a contract change; provides that except for costs associated with impossible or defective specifications, no claim will be allowed for costs incurred more than 20 days before the Contractor has notified the Contracting Officer in writing of any Government action or omission which the Contractor considers to constitute a change; provides that in cases of changes issued by someone other than the Contracting Officer, the failure to so notify the Contracting Officer releases the Government of liability for action the Contractor elects to take; and requires that any claims for adjustment under the clause must be asserted within 30 days although the Contracting Officer may act, at his discretion, upon claims asserted prior to final contract payment providing timely notice has been given.

The Contractor in the instant case has failed to comply with both the mandatory notification and claim assertion requirements, despite the facts shown in this CITAR that the Contractor knew or should have known the facts and circumstances necessary for him to have complied with the requirements of the changes article. His claim is untimely and the implication of his claim that his lack of timeliness in providing the required notice is excusable because of continued design evolution by the Government is unfounded as is discussed further in paragraph 4 below.

The Contractor has provided none of the Problem Identification Reports required by the contract that would have identified the problems that the Contractor now alleges, despite there being no valid reason for these alleged problems not having been previously known and identified.

The Contractor furthermore alleges in his claim that technical data received from the reactor plant lead yard required work that was not required by contract. The liaison procedures and background cited in paragraph II.A.9, pages 14-16 of this CITAR, make clear that the RPLY did not have the authority to issue documents that changed the contract between the Government and the Contractor. Paragraph II.A.9 also shows that the Contractor had the recognized responsibility if he thought RPLY documents required extra contractual work to not proceed with the work but promptly to identify the matter to the Government. Such notification was not provided with the exception of the Contractor's letter reference (d), that asserted testing of the system was outside the contract. Reference (e) stated reasons refuting the Contractor's arguments and the Contractor proceeded without response.

Accordingly, the Contractor claim is without merit.

2. Contract Requirements. The contract requires the Contractor to build and test reactor plant systems in accordance with non-deviation reactor plant working drawings and test procedures to be furnished by the Government, through its agents the Reactor Plant Contractor and the RPLY, as they are developed. (Contract article 9b, Sections 9890-1 and 9080-1 of the Ship's Specifications as cited in Sections IIA1-5, pages 5-8 of this CITAR). It was thus recognized by both parties prior to contract that the reactor plant working drawings and test procedures would not be available at time of contract. This is normal shipbuilding practice; the Contractor's own working drawings for those non-reactor plant systems for which he was the design agent also had not been developed at time of contract definitization. The Contractor entered the incentive type maximum priced contract freely and with that knowledge.

Prior to definitization , to show what features the RPLY reactor plant drawings would have when developed, the Contractor was given specifications including contract guidance drawings. The Contractor was given a contract guidance drawing for each nuclear fluid system including the system entitled "reactor compartment ventilation control air system." This system was specifically called out as being required by Section 9890-1, of the Ship's Specifications As required by Section 9890-1 of the Ship's Specifications the working drawings that were furnished were based on the contract guidance drawings (See Section II.A.2, page 6). The one exception was the addition of the high pressure air reducing stations not shown on the contract guidance drawings. That change was identified by the Contractor and negotiated and priced as HMR-145 (See Sections II.B.8 and 9 pages 23 and 24).

Thus, it can be seen that the contract requirement is for the Contractor to build the control air system in accordance with non-deviation working drawings to be furnished based on the contract guidance drawings. The Contractor in his claim does not indicate any action he was required to take that was not so required.

Thus, absent other Government actions or inactions that are a basis for entitlement, there is no contract or specification change required. It should be noted that the Contractor's cost breakdown in support of his requested adjustment for alleged added effort lists many of the same valves, manifolds, and other components that were explicitly listed on the original contract guidance drawing.

3. Allegations of Deficient Specifications

The Contractor alleges that the contract specifications (including the contract guidance drawings) were deficient in that the Contractor could not recognize the extent of the system he would be required to build and could "in good faith only assume that the system would be similar to the system employed in the DLGN36 Class." This allegation is controverted by the evidence,as was shown especially in Sections II.B.1 and 2, pages 20 and 21, and review of the contract guidance drawing itself, reference (a). Prior to contract definitization, the Contractor had this contract guidance drawing which listed the valves, manifolds, pressure gages, and the like that would comprise the system. Further, the Contractor's claim citing the words in Section 9890-1 that the CGN38 reactor plants would be "similar" to those in CGN36 as a basis for his position is also not consistent with the facts. Similar does not mean "identical". Further, as pointed out in Section II.B.2, page 21, the Contractor knew full well and based his bid on the fact that there would be 14 ventilation butterfly valves needing a control system as opposed to the CGN36 design with but five valves.

It may very well be true that the Contractor did not, during his bid proposal preparation, include a specific estimate for the CGN38 reactor compartment ventilation control air system. No evidence has been discovered to indicate he did include such an estimate. However, it was no action or inaction by the Government that caused his not having done so. The level of detail on the reactor ventilation control air system guidance drawing was consistent with that shown in contract guidance drawings for other nuclear systems. The reactor ventilation control air system contract guidance drawing did not show the number of feet of small air pipe that would be required (as the Contractor points out as if this fact supported his claim). The contract guidance drawing, however, did show all interconnections and components such that the Contractor could, using estimating factors, account for the system just as the Contractor accounts for other systems, both nuclear and non-nuclear, under his or another's (RPLY) design cognizance for which he does not have detailed working plans at time of contract. It is not the usual practice to show pipe lengths on contract guidance drawings, and the other reactor plant system contract guidance drawings do not do so either.

Based on the above, it is concluded that the Contractor's assertion of Government responsibility for what may have been his oversight in preparing his bid is a misrepresentation of the facts.

4. Design Evolution

The Contractor through a lengthy discussion of the evolution of the design apparently attempts to establish that: (1) regardless of the contract requirements, because there was not a detailed design at contract definitization, the Contractor had not contracted to build the developed design; and (2), the vagueness of the design provided an excuse for not promptly presenting the notices as required by the Changes article and Problem Identification Report article. The facts do not support the Contractor's position.

First, development of the system design details based on the contract guidance drawings after contract definitization, as pointed out in paragraphs 2 and 3 immediately above, was not unusual or unexpected and was provided for in the contract. The Contractor was well aware of these development and liaison procedures during his longstanding participation in the nuclear shipbuilding program, including CGN's 36/37, using non-deviation working plans furnished by a reactor plant lead yard. These procedures and the applicable contract and specification requirements for CGN-38 are discussed in detail in Section IIA9 and 10, on pages 14-19 above. By virtue of the control air system components and piping being run or mounted to, in, or around much of the structure and components designed and procured by the shipbuilder, liaison intercourse was required to enable the detailed non-deviation working drawings to be developed. As pointed out in Section II.B.16, page 29 and the RPLY's letter to the Contractor, reference (1), the RPLY's issue of the final drawings was dependent on the Contractor's previously providing design information on components being procured by the Contractor. There were no facts presented in the claim which indicate that the control air system design development was not handled and carried out in the contractually prescribed manner.

Secondly, with respect to testing, review of the test procedures shows that they were furnished as required by the contract and Ship's Specifications Section 9020-1 (See Section II.A.1 and 4, pages 6 and 7 above). The Contractor should have been aware, since test procedures were furnished for all reactor plant systems, that test procedures would be furnished for the reactor compartment ventilation control air system. Review of the test procedures shows that there were no unusual or special requirements in the test procedures that required exotic or unusual test equipment. That the Contractor may not have specifically included a separate estimate of effort to test the ventilation control air system in his overall estimate of reactor plant testing is not the Government's responsibility and does not relieve the Contractor of his obligations to test the system as required by the contract and specifications.

Third, the Contractor in his claim makes various allegations that he was unable to fully understand the extent of the system even when the non-deviation system diagram (working drawing) was issued in mid-1973 and the non-deviation detailed construction drawings were issued in mid-1974. He stated "Even after receipt of these plans, the full extent of the changes in the design requirements were unclear. The data contained therein were so incomplete and ambiguous as to preclude meaningful analysis." The Contractor's implication that he must be able to identify every pipe length and fitting before understanding the extent of a system for bid is not consistent with the facts as pointed out in paragraph 3 above. The Contractor's claim neglects to mention that in mid-1972 he had received a detailed non-deviation system diagram (working drawing) showing the extent of the system.

This drawing is discussed in Section II.B.6, page 22. Further, in his review of the mid-1973 revision to the system diagram (Section II.B.8 and 9, page 23) he identified as "out of scope" the additional components added for the air reducing stations not on the contract guidance drawings. Thus, it is apparent that the Contractor had detailed knowledge about the system, regardless of the contract guidance drawing, by mid-1972, and further, by mid-1973, even had sufficient knowledge as to make a determination that ordering and installing certain components in the air reducing station not shown on the Contract Guidance Drawing, were a change in contract requirements. Yet, in the current claim the Contractor is requesting payment for ordering and installing the components listed not only in the Contract Guidance Drawing but also in the two revisions of the system diagram issued in mid-1972 and mid-1973 respectively.

The Contractor's contention that he could not still have been aware of the full extent of the changes in the CGN-38 design requirements from CGN-36 even after the October and November 1974 receipt of working drawings is literally correct in the absolute sense that full means 100% in all manners, but is materially without substance since, as shown above, work scope can be adequately defined without all drawings being final.

As discussed in Section II.B.10, page 25, the detailed non-deviation construction drawings issued by the RPLY in late 1974 were essentially complete except for details of interface with Contractor furnished components for which the RPLY was awaiting design information. These reservations in no way affected the ability of the Contractor to be able to identify to the Contracting Officer in a timely manner if the ventilation control air system working drawings required work not covered by the Contractor.

It is concluded that the Contractor thus, even independent of the contract guidance drawings and specifications, had adequate information since mid-1972 to properly provide the contractual notice required if he were to be entitled to a contract adjustment.

5. Other Items

a. With regard to the three plan revisions notices the Contractor cited as representing extra contractual work, Section II.B.13, page 27 showed that these plan revision notices were normal and routine actions in the development of the system, as provided in the contract. They did not represent work added to that required by the contract. Regardless of entitlement, the work associated with resolution of this matter was an insignificant portion of the Contractor's overall effort claimed for the control air system. With respect to the Contractor's allegation that PRN-A-747 caused additional engineering work to incorporate the PRN it is concluded that the minimal effort to issue such a revision notice is routine work required by contract as an inherent part of building reactor plants in accordance with drawings furnished by the RPLY as they are developed. It is also noted that the RPLY would not have had to issue PRN's 742 and 743 had data on the components being furnished by the Contractor's vendor been previously sent to the RPLY. It is noted that each PRN contained the "disclaimer paragraph" and that the Contractor did not at the time they were received advise the Contracting Officer that any work required by these PRN's would require a contract change.

b. With regard to the submersible pressure switches and transmitters, it is noted that the Contractor (See Section II.B.14, page 27) in his LAR 776, reference (f), suggested a pressure tight enclosure and represented that such an action would not require a contract change. The Contractor participated in the decision to mount the switches in a bulkhead enclosure in lieu of their being submersible via references (g) through (j) and at no time during this development process advised that a contract change was required. It is concluded that the mounting of a non-submersible switch in a bulkhead enclosure was but a method to meet the requirement for submersible switches and transmitters. Regardless of entitlement, the work associated with resolution of this matter was an insignificant portion of the Contractor's overall effort claimed for the control air system.

c. The allegations of the Contractor's not receiving legible drawings, as discussed in Section II.B.16, page 29, are, for reasons cited in that section, considered to be without substance and not to be a basis for contract adjustment.

C. Summary/ Conclusions

The Contractor's claim is without merit.

The Contractor was required by contract to build the reactor compartment ventilation control air system in accordance with non-deviation reactor plant working drawings based on the contract guidance drawings and furnished to the Contractor as they were developed. The working drawings were based on the contract guidance drawings as is required by contract with the exception of the changes that were properly resolved between the Contractor and Government per HMR-145 as a contract change. No contract or specification change is required to cover the alleged added work.

The Contractor's contention that the Government's contract specifications, including the contract guidance drawings, were vague and misleading is contrary to the facts. The Contractor may have made the unfounded assumption that the control air system in CGN38 would be the same as that in CGN36, but that unfounded assumption is his responsibility. His allegations that he was mislead by the Government's actions or inactions is a misrepresentation of the facts.

The Contractor furthermore did not request a contract adjustment or provide the proper contractual notices in a timely manner as required by contract despite his apparently having timely knowledge to do so if he had contemporaneously considered the Government's actions or inactions required a change in the contract.

SECTION IV RECOMMENDED GOVERNMENT POSITION

A. SUMMARY

The Government's evaluation of this claim concludes the claim is without merit.

B. SPECIFIC RECOMMENDATION

A comparison of the Contractor's claim and the Government's position for manhours and material is:

SHIPS	PROD. M/H	ENGR. M/H	MATERIAL $	PROD. M/H	ENGR. M/H	MATERIAL $
CGN38	23,177	10,300	$65,483	0	0	$0
CGN39	23,177	1,700	$33,418	0	0	$0
CGN40	23,177	1,700	$33,418	0	0	$0
TOTAL	69,531	13,700	$132,319	0	0	$0

SECTION V - REFERENCES

(a) Contract Guidance Drawing, NAVSHIPS Number 800-4385731, "Diagram Reactor Compartment Ventilation Control Air System." (CONFIDENTIAL)

(b) Non-deviation working drawing (System Diagram), NAVSHIPS Number 245-4445028, EB Number 38643-01X01, "Diagram Reactor Compartment Ventilation Control Air System" Revision (a) (CONFIDENTIAL)

(c) Newport News TWX #107, dated 30 August 1973

(d) Newport News letter, Ser DRPD 2681/15 dated November 19, 1974

(e) NAVSEA letter Ser 08J-8411 dated 10 December 1974

(f) Newport News LAR 776 dated July 6, 1973 and 776 Supplement 1, dated 1 August 1973

(g) EB Quincy letter, Ser NSSP-397-74-LAS:JSS(863) dated March 21, 1974

(h) Newport News letter, Ser DRPD-2681/7 dated April 12, 1974

(i) EB Quincy letter, Ser NSSP-904-74-LAS:JSS(863) dated July 22, 1974

(j) Newport News letter, Ser DRPD 2681/13 dated August 29, 1974

(k) Plan Revision Notice (PRN) P-55 dated 2 July 1974

(l) EB Quincy letter NSSP-14-75-DMB:JJ(863) dated 6 January 1975

(m) NAVSEA letter 08M-1103 dated July 15, 1969

(n) Newport News letter (no serial) dated July 25, 1969

#15

Newport News Shipbuilding
A Tenneco Company

4101 Washington Avenue
Newport News, Virginia 23607
(804) 247-2000

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DENTIAL

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August 1, 1977

AUG 0 2 1977

ervisor of Shipbuilding
nversion and Repair, U. S. Navy
wport News Shipbuilding and Dry Dock Company
wport News, Virginia 23607

tention: Contracting Officer

bject: Proposals for Equitable Adjustment of Shipbuilding Contracts:
N00024-67-C-0325, CVAN68 and 69, submitted February 19, 1976;
N00024-69-C-0307, SSN686 and 687, submitted August 8, 1976;
N00024-70-C-0252, DLGN38/40, submitted August 8, 1975;
N00024-70-C-0269, SSN688, submitted March 8, 1976
N00024-71-C-0270, SSN689, 691, 693 and 695, submitted March 8 1976

ear Sir:

Since the subject proposals were first submitted, there have been changes the projected final costs. Some of the changes in estimated final costs represent creases from estimates contained in the proposals which could be a factor in your eview process.

The listing below compares the estimated final costs in the proposals with the current estimated final costs for each contract. Dollar amounts shown do not include financing.

Ship(s)	Contract	Estimated Final Cost in Proposal (in millions)	Current Estimated Final Cost (in millions)
CVN68/69	N00024-67-C-0325	$932.6	$960.9
N666/687	N00024-69-C-0307	133.4	133.4
LGN38/39/40	N00024-70-C-0252	448.2	404.4
SSN688	N00024-70-C-0269	114.0	126.3
SSN689/691/693/695	N00024-71-C-0270	383.0	374.7

Naturally, we request that the confidentiality of these projections be maintained.

C0174 CG147

Yours very truly,

C L Willis
C. L. Willis

COMPANY
CONFIDENTIAL

Copies
C. E.
V. F.

#16

Newport News Shipbuilding
A Tenneco Company

4101 Washington Avenue
Newport News, Virginia 23607
(804) 247-2000

CONTRACTS/GEN

June 14, 1976

The Honorable William P. Clements
Deputy Secretary of Defense
Room 3E942, The Pentagon
Washington, D.C. 20310

Dear Secretary Clements:

Confirming our discussion on June 2, the negotiations between Newport News Shipbuilding and the Shipbuilding Executive Committee have reached a stalemate. By separate letter this date to Admiral Michaelis, I am reviewing the status of the outstanding nuclear shipbuilding contracts and our proposed course of action.

I had hoped that the parties concerned would fully embrace your concept that there is enough fault to go around for everyone. More specifically, I had expected that the Navy was prepared to propose a solution which would provide for the Government taking responsibility for certain inflation—amounting to some $200,000,000 in current estimates. On the other hand, the Company was prepared to be responsible for the other cost growth and therefore would release our claims—amounting to substantially more than $200,000,000. This would have resulted in a break even situation for Newport News for constructing $2.5 billion worth of nuclear ships for the Navy. This solution has not been reached, and our offer to do so is withdrawn.

From my point of view, the root of the problem is that the Navy's offer does not compensate Newport News for escalation costs to the same degree as would be anticipated under a new Navy shipbuilding contract or perhaps under other existing contracts with other shipbuilders. I recognize that the Committee has offered a clause that is, in form, substantially the same one contained in the recent contract for Destroyer Tenders. However, two principal features of this clause are (i) that the rate of compensable escalation stops at the contract delivery date, and (ii) that the amount of escalation stops when the unescalated costs of the contractor reach the ceiling price. Thus, in order for the clause to be equitable, both the delivery dates and the ceiling prices must be realistic.

This needed realism was not present in the Committee's proposal to Newport News. The Committee's offer cuts off escalation growth at existing contract delivery dates which, in some cases, have already passed. In addition, it cuts off escalation compensation at the current contract ceiling which in all cases, except the Carrier contract, is unrealistically low as a benchmark for escalation.

We have offered every manner of compromise which would alleviate the constraints of these two items but so far have been unsuccessful. If, for example, as I discussed with you and as is the case with Electric Boat, our 688 class claims were settled prior to including escalation, the result would have been acceptable.

I wish to also point out that the Committee proposal had numerous other features that we found objectionable.

For example, the treatment of the pricing of change orders--although contained in some escalation clauses currently in effect--works a severe inequity in our situation. It compounds the delivery date and ceiling price problems alread referred to, as well as reverses certain equitable price adjustments that have alrea been made to our contracts.

In addition, the release language is particularly onerous and bears no relationship to the ordinary and reasonable dealings between the Navy and its contractors--or even to the release language set forth in the Armed Services Procure Regulation.

Another feature of the proposal is to settle outstanding changes without consideration of any additional delays which could occur. This, in effect, not only absolves the Navy of responsibility for those change orders involving the whole issue of "cumulative impact," but also fails to recognize several major change orders involving critical design deficiencies by the Government that have had direct delay impact and that will cost tens of millions of dollars in lost time.

Finally, we find unacceptable the proposal's attempt to directly involve th Navy in the basic right of management to allocate manpower.

The problems I've addressed so far involve essentially formal contractual matters. But there is another basic issue about which I am equally concerned--the significant and serious deterioration of day-to-day relationships between the Navy and our Company. The Navy has failed to establish new contract provisions that would eliminate, or at least minimize, in the future the lengthy disputes which have characterized the past. A clause for full escalation would, of course, alleviate the disputes.

I see no evidence to indicate a more reasonable approach by the Navy to our mutual problems. I see only the grim prospects of a continuation of the current adversary relationship, with the attendant grave implications not only for the Compan but also for the Navy, the defense industry as a whole and, importantly, for our thousands of employees.

Our best efforts to date have met only with failure. Rancor and recriminati have been the only results obtained, and this raises the serious question of whether our Company and the Navy can ever again achieve a productive and mutually satisfactory relationship.

A great deal has been said about the problems attendant to a timely evaluati of our claims, although we have emphasized that the subject matter of these claims ha generally been raised with the Government as the problems arose during the constructio period. Perhaps the most prudent step for the Navy would be to have a one-year hiatus in the nuclear Naval shipbuilding program which would give the Navy time to straighten out its affairs. In addition, hopefully it would afford them access to the funds necessary to properly fund their existing obligations.

Notwithstanding the efforts at the very highest level of the Department of Defense, there is no progress towards curing the underlying problems. In the face of that fact, I have reluctantly reached the conclusion that continued one-sided contract performance by Newport News subjects this Company to irreparable damage. I consider that there exists a fundamental breach on the part of the Navy of its obligation to provide equitable compensation for its actions. This includes not only full compensation, but prompt compensation.

I have today sent to Admiral F. H. Michaelis a summary of the status of our Nuclear Naval shipbuilding contracts, including a brief statement of our proposed course of action with regard to each of them. Included in that letter is a description of a method to achieve an orderly withdrawal from our continued participation in the Nuclear Naval shipbuilding program if we are unable to promptly reach a reconciliation. This proposal includes cooperation in transferring the CVN70 to Puget Sound Naval Shipyard and of the follow-on SSN711-715 ships to Mare Island Naval Shipyard. We anticipate that our position is correct with regard to DLGN41 and that it will be cancelled.

This will enable me to redirect the efforts of our Company to enterprises which at least hold out the promise of mitigating our damages and shorten the time frame in which we will be exposed to that continued Navy conduct which now threatens our survival. I trust you will use your good offices to make this transition as amicable as possible.

Yours very truly,

J. P. Diesel
President

FHC:dmw

EXHIBIT W

AUGUST 5, 1982 -- WEINER MEMO

Memorandum

Subject
Review and Recommendation to Continue Investigation of Newport News Shipbuilding and Dry Dock Company

Date
5 AUG 1982

ECW:amb

To
Robert W. Ogren
Chief, Fraud Section
Criminal Division

From
E.C.W.
Edward C. Weiner
Deputy Director
Office of Economic Crime Enforcement
Criminal Division

I.

INTRODUCTION

I have been asked to conduct a comprehensive and objective review of the criminal investigation of Newport News Shipbuilding and Dry Dock Company that was handled by the United States Attorney's Office for the Eastern District of Virginia and the Fraud Section. I was instructed to be as thorough as possible and to use my own judgment in attempting to fill any factual gaps I found. The methodology I employed and the documents and people I consulted are detailed in Appendix A to this memorandum. Two major parts of the investigation are mentioned throughout: the Richmond phase and the Alexandria phase.

The Richmond prosecution team began work in the Summer of 1978. The first Richmond Grand Jury issued subpoenas in October 1978. The Richmond prosecutors consisted of Assistant United States Attorney Eliot Norman, Navy attorneys (Special Assistant United States Attorneys) Saundra J. Adkins and Eugene B. Paulisch, and Fraud Section Attorneys Joseph P. Covington and Linda L. Pence. After 18 months of investigation before two grand juries, the Richmond prosecutors recommended declination. The Alexandria prosecution team rejected that recommendation, moved the matter from Richmond to Alexandria, and decided to focus on one claim item. The Alexandria prosecutors consisted of Assistant United States Attorneys Joseph A. Fisher, III and Joseph J. Aronica and Appellate Section attorney David B. Smith. After 6 months of investigation including grand jury work, the Alexandria prosecutors recommended continued investigation and eventual indictment. I believe that continuation of the investigation is warranted at this time although problems may be encountered that might possibly militate against later indictment.

I will not duplicate to any extent here the matters discussed in the lengthy prosecution reports of the Richmond and Alexandria prosecutors. Instead (after a summary of the facts), I will focus on mostly new material setting forth evidence of an alleged conspiracy to inflate claims and discussing some relevant policy considerations.

II.

SUMMARY OF FACTS

In March 1976, Newport News Shipbuilding and Dry Dock Company (NNS) filed a revised claim (known as the "Maxi" claim) with the Navy requesting adjustments in the prices and delivery schedules of 14 ships which were either completed or under construction by NNS. The claim superceded a previous claim submitted in August 1975 (known as the "Mini" claim). The final claim covered contracts on the following ships:

- 7 submarines: L. Mendel Rivers (SSN 686), Richard B. Russell (SSN 687), Los Angeles (SSN 688), Baton Rouge (SSN 689), Memphis (SSN 691), Cincinnati (SSN 693), and Birmingham (SSN 695).

- 5 cruisers: California (DLGN 36), South Carolina (DLGN 37), Virginia (DLGN 38), Texas (DLGN 39), and Mississippi (DLGN 40).

- 2 aircraft carriers: Nimitz (CVN 68) and Dwight D. Eisenhower (CVN 69).

In February 1977, the Navy settled a claim on two of the ships and on October 5, 1978 (after review by a special Navy board) it settled with NNS on the contracts for the remaining 12 ships. The total cost overrun settlement was $208 million of the $894 million claim submitted by the company. The settlement purported to end all litigation between NNS and the government over the claims. This sum was over and above the actual progress payments made by the Navy (approximately $2.5 billion) as the ships were being constructed. The contracts between NNS and the Navy were fixed-price incentive contracts with provision for progress payments and profits but no agreed-upon price. Approximately 80% of the overruns claimed by NNS fell into the categories of "delay, disruption, and deterioration of labor." These are the so-called "soft" items. The "hardware" or "hard" items are specific components or systems in the various ships which are constructed according to drawings and specifications provided by the Navy. The special Navy board settled the claims primarily based on "litigating risk" and pointed out 47 different claim items (of approximately 300) which presented the possibility of fraud. The Richmond and Alexandria prosecutors concentrated on approximately 20 of these.

A. The Hardware Items

1. Ventilation Control Air System

The investigation regarding the Reactor Compartment Ventilation Control Air System on the Class 38, 39, and 40 cruiser was extremely comprehensive as is fully described in the Alexandria prosecution report. The allegation that NNS fraudulently submitted a claim and pegged it to an allegedly vague government guidance drawing instead of admitting that it "missed the bid" was proven to my satisfaction. However, it should be pointed out that NNS withdrew this claim item and was not compensated for it. This item establishes the methodology of the NNS claims process.

2. Bow Dome

The investigation regarding the Glass Reinforced Plastic Bow Dome on the Class 688 submarines is described in the Richmond prosecution report. The allegation that NNS falsely claimed additional costs due to a design change in the bow of the submarine (from welding to bolting) was not resolved. Reliance on the legal advice of outside counsel [redacted] can be asserted as a defense. In any event, I believe that the claim item on the Bow Dome was so small ($75,000) that further investigation may not be warranted.

3. Cathodic Protection

The investigation regarding Cathodic Protection on the Class 688 submarines (the installation of zinc to ship hulls for protection against salt water) is described in the Richmond prosecution report (separate memorandum of Navy attorney Eugene B. Paulisch). Reliance on [redacted] advice to press this claim [redacted] leads me to conclude that prosecution may not be warranted. It should be noted that because the Class 688 was a new submarine, there were many change orders and much confusion during construction. Intent to defraud would be difficult to prove.

4. Copper Nickle Tubing

The investigation regarding pricing of Copper Nickle Tubing on the Class 688 submarines is described in the Richmond prosecution report. Apparently, NNS withheld the pricing information in the Mini claim but reported it accurately in the Maxi claim. Although I believe that a specific false claims count is not warranted here, the withholding of the information (to the tune of $600,000) could possibly be used as an Overt Act in a conspiracy charge.

5. Intermediate Gage Cutout Valves

The investigation regarding the added work of installing Intermediate Gage Cutout Valves on the aircraft carrier Nimitz is described in the Richmond prosecution report. [redacted] eventually the claim item was withdrawn. The facts date back to 1968 and since there appear to be no intentional misstatements, I believe that prosecution is not warranted.

6. Discharge Sea Chests

Analysis regarding Discharge Sea Chests (openings in the ships' hull from which cooling water is discharged) on the Class 38, 39, and 40 cruiser is included in the Alexandria prosecution report. It is alleged by the Navy analysts that NNS sought government payment because of its own oversight of guidance drawings. Some investigation may be indicated.

7. Reactor Shielding

Analysis regarding Reactor Shielding (lead panels surrounding the nuclear reactor) on the Class 38, 39, and 40 cruiser is included in the Alexandria prosecution report. It is alleged by the Navy analysts that NNS improperly blamed the government for defective specifications when the real cause for cracks in the shielding was poor workmanship by NNS. Some investigation may be indicated.

B. Delay, Disruption, and Deterioration of Labor

1. Nimitz Delay

The investigation regarding delay in nuclear testing and delivery of the aircraft carrier Nimitz is described in the Richmond prosecution report. The test program of the nuclear reactors must be carefully performed and obviously delay will occur. The fact that NNS calculated 160 government-responsible days of delay but only claimed 123 days arguably precludes prosecution. However, I believe inquiry should be made as to how NNS calculated delay at $125,000 per day (total of $15.6 million).

2. Dwight D. Eisenhower Delay: Shipway Utilization

The investigation regarding delay in delivery of the aircraft carrier Dwight D. Eisenhower (alleged by NNS to be due to government-responsible delay on the Nimitz) is described in the Richmond prosecution report. Because of delay on the Nimitz, NNS says it moved construction of the Dwight D. Eisenhower from Shipway 11 to Shipway 9, a smaller facility, which resulted in construction delays. The Navy says that delay was due to insufficient manning by NNS not use of the smaller shipway. If (as the Richmond prosecution report states) no compensation was eventually requested by NNS, prosecution is not warranted. However, I believe that there is a $90 million claim item under this category. If so, more analysis is necessary.

3. Dwight D. Eisenhower Delay: Innerbottom Shielding

The investigation regarding delay in delivery of the aircraft carrier Dwight D. Eisenhower because of Navy change orders on the innerbottom shielding surrounding the nuclear reactors is described in the Richmond prosecution report. The report states that no compensation was requested by NNS on this item.

4. Deterioration of Labor (Parkinson's Law)

Analysis regarding the assertion of a claim for "deterioration of labor" is included in the Richmond prosecution report under the heading "Fictitious Manhours." The report states that NNS asked for $78 million in "deferred work" with respect to the five Class 688 submarines. The deterioration of labor theory of entitlement is also applied to the other ships in the claim. It amounts to approximately $100 million and is based on the unusual application of "Parkinson's Law."

In 1957, a British academician (Parkinson) postulated that in a bureaucracy there is an inexorable growth over time of the number of people hired to accomplish a given amount of work. NNS alleges that the Navy is responsible for all delays and thus with every revision in delivery schedules of the ships NNS' workers became less efficient. According to NNS, 15 minutes out of every productive labor hour spent in the month following a schedule change was wasted due to Parkinson's Law; the second month, 13 minutes an hour was wasted; the third month, 9.5 minutes, and so on until the next schedule revision. At that time, the calculation is repeated.

I believe that the bald assertion of Parkinson's Law in the context of the shipbuilding industry without the support of any empirical studies is outrageous and fraudulent.

C. Other Soft Items

1. Navy Recruiting Practices

The investigation regarding Navy recruiting practices is discussed in the Richmond prosecution report (separate memorandum of Fraud Section attorney Linda L. Pence) and analyzed in the Alexandria prosecution report. NNS alleges that the Navy (Norfolk Naval Shipyard) recruited 720 NNS employees and that the Navy owes NNS for recruiting and training replacements (to the tune of $24 million). If NNS had spent what it claimed to train these new hires ($35,000 for each design employee, $25,000 for each production employee), the total training cost for all new hires for 1973-1974 would have been $380 million, a preposterous sum. During the relevant period, NNS also recruited Navy employees to work at NNS yet the company made no effort to offset. I believe that employees should be free to voluntarily accept new jobs anywhere (including the Norfolk Naval Shipyard). This claim item is ridiculous.

2. Added Financing Costs

Analysis regarding the assertion of a claim for added interest or financing costs because of late government progress payments is included in the Alexandria prosecution report. If the Navy was late in submitting progress payments, it violated the terms of the contract and NNS might have grounds for entitlement. But the large figure claimed (over $50 million) and the questions concerning method of calculation indicate further investigation.

3. Impact of Environmental and Safety Regulations

Analysis regarding the claim for increased costs due to environmental and safety legislation is included in the Alexandria prosecution report. The issue is whether the original contract assumed that NNS would absorb the costs of complying with the new environmental and health and safety regulations. Even if it did not, there may be no legal basis for entitlement. Further investigation is indicated.

III.

ALLEGATIONS OF A CONSPIRACY TO INFLATE CLAIMS

I believe that a sophisticated conspiracy to inflate claims regarding cost overruns was begun by NNS in the late summer of 1974 (the formation of the Contract Controls Department). The Richmond prosecution team did some work on this aspect of the case but did not make much headway. The Alexandria prosecution team analyzed the allegations [redacted] I have done a little bit of investigative work but it may be too late at this point (8 years after the fact) to prove the conspiracy beyond a reasonable doubt.

NNS was acquired by Tenneco, Inc., a Houston, Texas conglomerate, in 1968. A monument at the shipyard was removed by Tenneco management in April 1969. The monument contained the following statement by the founder of NNS: "We shall build good ships here at a profit if we can -- at a loss -- if we must but always good ships." The general belief is that attitudes and conditions changed at NNS from that time forward. A Tenneco-selected chief executive (John P. Diesel) became President of NNS in June 1972 and Chairman of the Board in September 1973. At that time the company had contracted for and was building various ships for the Navy. Most of these ships were nuclear powered and thus their design and construction were supervised by Admiral Hyman G. Rickover and his staff. Admiral Rickover alleged that the claims were ginned up and that false and fraudulent statements permeate NNS' claims.

A. The Cardwell Testimony

William C. Cardwell, a former NNS employee and member of the Contract Controls Department, testified before Senator William Proxmire's Subcommittee on Priorities and Economy in the Government on June 7, 1976.

POLICY CONSIDERATIONS

A. Statute of Limitations Implications

The initial NNS claim was filed on August 8, 1975. It was revised and a final claim was submitted to the Navy on March 8, 1976 (beyond the normal five year statute of limitations). Thus, a false claim prosecution (18 U.S.C. Section 287) based on the March 8, 1976 submission is barred by the statute of limitations. However, I agree with the Alexandria prosecution team that the statute begins to run anew when and if the contractor files a subsequent amendment to its claim. In addition, a false claim conspiracy theory (18 U.S.C. Section 286) or a mail fraud theory (18 U.S.C. Section 1341) could extend the time period up to at least October 5, 1978 when NNS settled the claim on the 14 ships with the Navy (the statute would then run on October 5, 1983). Although I have not selected out the relevant documents, there are several letters back and forth between NNS and the Navy during 1977 and 1978 that could be utilized in mail fraud counts. For example, there is a letter dated April 20, 1978 stating that NNS' review has disclosed no major errors or inconsistencies in the Requests for Equitable Adjustments.

A more significant problem is the policy consideration of continuing an investigation that began at least four years ago[redacted]

[redacted] But it was not until the Spring of 1978 when any real investigative strategy was formulated. At that time Fraud Section Attorney Joseph P. Covington replaced Kurimai and had meetings with the FBI preliminary to a full grand jury investigation. The Richmond Grand Jury began work on the case in October 1978. I believe that the Department of Justice should have begun this investigation in earnest in the Summer of 1976

B. The Rickover Factor

Admiral Hyman G. Rickover first accused NNS of fraud in these claims shortly after they were submitted in 1976. However, there is a long and acrimonious battle between Rickover and the company which is documented in Rickover's testimony on Capitol Hill, in press accounts, and in NNS' internal memoranda. NNS lobbyist Thomas G. Corcoran was very interested in preventing Rickover's reappointment to Navy service as far back as the late 1960's. Rickover constantly feuded with NNS Chairman John P. Diesel and at various points suggested that the government buy out the shipyard and build its own ships.

NNS' criminal counsel has raised this "Rickover factor" in its confidential memorandum to the U.S. Department of Justice (pages 115-139) and no doubt would emphasize it as a defense if there were a trial. There is no doubt in my mind that a good case could be made that Admiral Rickover and his staff could be painted as viciously carrying out a vendetta against NNS and maliciously accusing the company of fraud when in fact there was none. I personally believe that Admiral Rickover and his staff were following the proper and patriotic course in working to uncover NNS' fraud. However, the Richmond Grand Jury investigation should have been (and I think it was) independent of Admiral Rickover and thus immune from any charge that Rickover orchestrated the criminal investigation. After all if Rickover's wishes had been followed, the case would have been indicted in 1978 or 1979.

My own theory of what occurred in the NNS claims process is related to the Rickover factor. I should point out that my theory has not been substantiated and probably cannot be. It goes something like this: In 1969, L.C. Ackerman became President of NNS. He immediately encountered Rickover who was very demanding. Rickover stressed the need for superior performance from NNS in building nuclear-powered ships. Ackerman felt constantly harassed by Admiral Rickover. Ackerman was basically an honest man who had to cope with pressures from Rickover as well as corporate headquarters. Ackerman capitulated to Rickover in 1971 in signing a letter concerning a contract to build submarines and in the process renouncing the advice of his own executives. Although the submarines were being built very soundly and nuclear safety was assured, the company was not showing a profit. Ackerman continued to be harassed by Rickover and wanted out. In 1972, John P. Diesel was brought in as NNS President and Ackerman was temporarily "kicked upstairs" and resigned one year later. From the start, Diesel was out to best Rickover. Diesel would not let Rickover dictate to him. He also was very concerned about profit and loss. Diesel had no experience in shipbuilding but was cracked up to be a good manager. In my opinion, Diesel was dishonest; he deliberately set up a claims process which would lead to exorbitant claims. He sized up his personnel well and was able to use F. Hunter Creech and C. Leonard Willis out front to create a massive amount of paper which the Navy might not be able to digest. Employees who had no previous experience in claims suddenly were thrust into the process and came up with unbelievable estimates for delay, disruption, and deterioration of labor. He also was able to rely on and use the experience and ability of Executive Vice President Charles E. Dart in justifying the claims. Diesel was not beyond blackmailing the Navy in threatening to stop construction of Navy ships (NNS did stop work on the Class 41 cruiser for a while). He apparently used the same "confrontation" tactics with his employees (periodic layoffs occurred) and labor unions as well as Rickover. Diesel resolved to spurn settlement until he was able to recover $200 million; his strategy was to claim four or five times that amount. The strategy worked. Diesel is now Chairman of the Board of Tenneco.

C. Civil Versus Criminal Action

I believe the question should be raised that the NNS investigation (as well as the other three criminal investigations of shipbuilders) should have been handled civilly rather than criminally.

In such a posture a civil suit under the False Claims Act (31 U.S.C. Section 231) which permits double damages would be a much better vehicle for recovery and possible deterrence of fraudulent activity. In addition, the burden of proof in a civil case is much less than that in a criminal case and thus the chance of success would be much greater.

Although it is not clear from NNS' settlement agreement with the Navy Claims Settlement Board (dated October 5, 1978), it could be argued that the settlement agreement precludes subsequent civil litigation by the government to recover allegedly false claims. NNS' criminal counsel has raised the issue that the settlement agreement is also a bar to criminal prosecution in its confidential memorandum to the U.S. Department of Justice (pages 140-143). I believe that the Navy clearly intended to preclude all civil ? litigation by settling the claims with the company. However, the reservation clause of the settlement agreement reserves any rights the government may have under certain criminal statutes (18 U.S.C. Sections 286, 287, and 1001) and also under 31 U.S.C. 231 (the civil False Claims Act).

Although I believe that it would be imprudent to proceed civilly against NNS, the civil alternative is a viable one and should be considered in future cases like this.

D. The Debarment/Suspension Possibility

NNS is reportedly the best of the private shipyards that build and overhaul nuclear and non-nuclear ships for the Navy. It has a long history of excellent craftsmanship and has been awarded several more contracts to build submarines, cruisers, and aircraft carriers which are now under construction. I have raised the matter of possible debarment and suspension of NNS (in the case of an indictment and conviction of the company) with the Richmond and Alexandria prosecutors. Although I don't know all the procedures involving debarment or suspension of a government contractor, I do know that the matter is solely within the purview of the appropriate agency (the Navy) rather than the Department of Justice. The consensus of the people I talked to was that there was no way NNS would be debarred or suspended by the Navy. The company's work is simply too vital to the national defense for the Navy to take any steps to halt NNS' work in building ships for the government. Apparently, debarment is not automatic with a company's criminal conviction but requires affirmative action on the part of the agency. I do not know about suspension (perhaps during the pendency of the criminal case).

A related issue is the possibility that at the time of an indictment against NNS the company might voluntarily get out of the business of building ships for the Navy. Diesel seriously considered this alternative in early 1978 at the time he ordered a work stoppage on the Class 41 cruiser (Note: a government lawsuit forced construction work to continue). Internal NNS documents disclose that NNS had enough private shipbuilding business (oil tankers) at that time to prosper. In fact construction of the North yard at NNS was to handle commercial shipbuilding activities. Admiral Rickover's suggestion that the government take over Navy shipbuilding might become a reality. My feeling is that if that were the case it would lead to massive layoffs among the 25,000 employees at NNS and at the other private shipyards.

I should point out that all of this is mere speculation on my part. I do not believe that the Department of Justice should be influenced in making a decision to prosecute or not to prosecute a case based solely on these considerations. The only relevant factor should be whether there is sufficient evidence to prove a criminal violation. However, where the evidence is borderline, policy considerations such as these may be weighed.

V.

CONCLUSION

The approach of the Richmond prosecution team (and to a lesser extent the Alexandria prosecution team) was to scrutinize specific "hardware" items in the claim. This required deep immersion in technical detail. The theory was that if the back-up documents were not totally supportive of a claim item or if a multitude of errors occurred, fraud could be proven. Although I don't believe I would have pursued that methodology in the investigation, I believe no one can be accused of "botching" it. I believe that a lot more attention should have been devoted to the initial allegation of a company-wide conspiracy to inflate claims. I have attempted to do so in Part III of this memorandum. I also believe that the "soft" items such as delay, disruption, deterioration of labor, and Navy recruiting practices should have been taken apart and shown to be outlandish. The Richmond prosecution team's conclusion that the claims writing process had integrity appears to be based only on the hardware items. I believe that the final claim narratives withstood analysis during the grand jury investigation because they had been massaged and perfected through many drafts. If prior drafts had been found for hard items, perhaps the Richmond prosecutors would not have recommended declination. In any event, the soft items constitute approximately 80% of the claim and may not be so immune from the discovery of "holes" in their entitlement theory.

My belief is that a continued investigation should focus on the NNS claims effort as a conspiracy to obstruct, impede, and delay the lawful function of government (18 U.S.C. Section 371) and the orderly claims process (18 U.S.C. Section 286).

cc: D. Lowell Jensen
Roger M. Olsen
James J. Graham
David B. Smith
Elsie L. Munsell
Joseph J. Aronica
Joseph A. Fisher, III.

APPENDIX A

METHODOLOGY OF REVIEW

During my tenure with the Organized Crime and Racketeering Section (1973-1980) I reviewed approximately 300 cases for prosecutive merit under the Racketeer Influenced and Corrupt Organizations (RICO) statute. This review of the investigation of Newport News Shipbuilding and Dry Dock Company was undertaken by me with the same objectivity and thoroughness I believe I brought to my previous assignments. This endeavor, however, was vastly more extensive and complicated than any other case review I had done. Because of its importance, I am setting out here the procedures I employed and the materials I examined during this review.

EXHIBIT X

SEPTEMBER 1, 1982 -- MEMO FROM SMITH TO OGREN

Memorandum

FRAUD SECTION
SEP 7 11 34 AM '82
DEPARTMENT OF JUSTICE

Subject INVESTIGATION OF NEWPORT NEWS SHIPBUILDING	Date September 1, 1982

To	From
Robert W. Ogren, Chief Fraud Section Criminal Division	David B. Smith DBS Trial Attorney Criminal Division

1. Having read Ed Weiner's fine memo of August 5, 1982, recommending that the investigation of the shipyard continue, I want to urge you to move forward as quickly as possible to implement that recommendation. I think it is obvious that a prompt commitment of substantial prosecutorial resources is necessary to bring the investigation to a successful conclusion before the statute of limitations runs out on October 5, 1983. As Ed's memo points out, the Department was first asked to investigate NNS' cost overrun claims in July 1976, by Senator Proxmire. I don't see how our collective performance since that time can be viewed as anything but dropping the ball. Fortunately, there is still time to put the matter right if we make the effort.

2. I also want to take this opportunity to express my thoughts on a couple of points in Ed's memo. Ed speculates that if NNS is indicted, there is a "possibility" that the company might decide to get out of the business of building ships for the Navy. This seems completely implausible to me. This country's private shipbuilding business has dwindled almost to nothing in the last few years, so NNS has no choice but to build for the Navy or not to build at all. Given the enormous naval shipbuilding program the Administration has embarked upon, and Admiral Rickover's retirement, building ships for the Navy should be very profitable over the next decade even without fraud. Tenneco simply can't afford to close the shipyard and it has no reason to do so, whether or not it is indicted.

128

I agree with Ed's statement that more attention should have been devoted to developing evidence of a company-wide conspiracy to inflate claims and to "taking apart" the outlandish claims on the soft items -- delay, disruption, deterioration of labor, Navy recruiting, OSHA and EPA regulations, etc. Even the dullest juror could understand the fraudulent character of these claims. In my opinion, the soft claim items provide a sufficient basis for a

NNS-73

conspiracy indictment by themselves. NNS might try to convince the jury that all defense contractors make similarly outrageous claims on soft items and that [redacted] I am reasonably confident that such a defense would fail because it is both legally and factually incorrect and because it would not appeal to a jury in any event. 1/ Indeed, I doubt that the trial judge would permit NNS to present evidence that other defense contractors also make outrageous claims on soft items, because it is legally irrelevant whether other companies also break the law.

GJ

All this is not to suggest that we cannot prove that many of the hard items are also fraudulent. We demonstrated in our November 1981 status report that the Ventilation Control Air System (VCAS) claim was fraudulent and we showed that a number of other hard items also appeared to be fraudulent, even without the benefit of a grand jury investigation of them. [redacted]

GJ

[redacted] Motions to dismiss indictments based on preindictment delay are rarely successful and such a claim ought to fail in this case where the size of the conspiracy and its complexity made substantial delay inevitable. Should the court nonetheless dismiss the indictment we could always appeal.

822

5. Finally, I wish to suggest that an indictment in this case would be in the public interest even if we do not obtain a conviction. The case is unique in several respects and I see no reason to judge it by the standards set forth in the Department's prosecutorial guidelines, which were never intended to govern every case. Although I expect a conviction, I would argue that an indictment should be sought even if I thought a conviction unlikely. In my

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1/ The fact that other defense contractors have often exaggerated soft item cost overrun claims is not a reason for us to decline to prosecute NNS. The company's claim is probably the biggest in history and the most fraudulent. A line must be drawn somewhere and an example must be made of someone.

opinion, it is essential that we send a message to NNS and to the defense contractor community that this type of massive fraud will not be tolerated by the DOJ, whatever the Defense Department's attitude is. In this time of budget austerity combined with a rapid build-up of our armed forces, it is particularly important that fraud on the part of defense contractors be discouraged. Because such fraud has not often been vigorously prosecuted in the past, it appears to be rampant today. Given the fact that the defense contractors are some of the biggest corporations in the country, I find this situation deplorable. But the fact that the defense contractors form a small, elite community also suggests that a single prosecution can have a real deterrent effect.

I recall my corporate—law professor, Joseph Bishop, explaining the effect of the criminal antitrust case brought against a group of General Electric Corporation executives charged with price-fixing in the 1950's. When they were actually sent to jail, the business community took careful note of the fact. A whole generation of law and business school students became acquainted with the *GE* case and through it their minds were marvelously concentrated on the perils of price-fixing. If I recall correctly, Professor Bishop indicated that the *GE* case resulted in a marked decrease in price-fixing behavior by big corporations.

Because major companies dread unfavorable publicity, an indictment is almost as effective in deterring criminal behavior as a conviction. An indictment would also serve the important function of bringing the facts to the attention of Congress and the public. Surely the public should be informed of a carefully orchestrated, cynical, $900 million raid on the Treasury by a major corporation, whether or not the government ultimately obtains convictions. In sum, I urge you not to let whatever doubts you may have about the outcome of the case deter you from bringing an indictment.

cc: Edward Weiner
D. Lowell Jensen
Roger M. Olsen
Elsie L. Munsell
Joseph A. Fisher, III
Joseph J. Aronica

823

EXHIBIT Y

NOVEMBER 17, 1982 -- DISSENTING MEMO FROM WEINER TO OGREN redacted

Memorandum

Subject
Dissenting View on Investigation of Newport News Shipbuilding and Dry Dock Company

Date
November 17, 1982

ECW:amb

To
Robert W. Ogren
Chief, Fraud Section
Criminal Division

From
Edward C. Weiner
Deputy Director
Office of Economic Crime Enforcement
Criminal Division

E.C.W.

On November 9, 1982, you informed me that you would recommend declination of the Newport News Shipbuilding and Dry Dock Company case. You also indicated that you would articulate your views in a memorandum to Assistant Attorney General D. Lowell Jensen. Although I have not yet seen your reasons in memorandum form, my meetings with you and Branch Chief Morris B. Silverstein on October 12, 1982, October 20, 1982, November 3, 1982, and November 9, 1982 gave me the basis for your decision -- specifically, the case was simply too old and there was no deception in the company's claim. As you know, I disagree with your reasons and request that this memorandum along with my Review and Recommendation (dated August 5, 1982) and my Work Plan (dated September 24, 1982) be considered by the Assistant Attorney General (Criminal Division) as my dissenting view.

1. Statute of Limitations/Conspiracy Theory

As a result of instructions from you and Mr. Silverstein, I did not follow the "game plan" of my September 24, 1982 memorandum which was primarily directed toward active investigation of the conspiracy to inflate claims. Instead, I tracked down and located some specific documents indicating that the government would definitely prevail on a statute of limitations attack if an indictment were returned prior to October 5, 1983. These documents were a series of October 5, 1978 letters by Newport News Shipbuilding and Dry Dock Company (NNS) to the Navy Claims Settlement Board assuring the government that the claim items were accurate and complete. I also examined documents and determined that two items were withdrawn by NNS prior to settlement. Significantly, it was determined that the claim on the Ventilation Control Air System was withdrawn on September 26, 1978. I believe, however, that prosecution on this item is still possible based on a conspiracy theory or even based on a specific false claim if the indictment were returned prior to September 26, 1983.

828

Unlike you and Mr. Silverstein, I believe there is sufficient proof based on the [redacted]nd other evidence to show a conscious attempt to obstruct the government. I believe that there will be a "linkage" shown between the actions of C. Leonard Willis (Director of

Contract Controls) and the sophisticated and successful effort by NNS to submit fraudulent claims. I believe that a continuation of the investigation along the lines I proposed in my Work Plan of September 24, 1982 would permit a final determination of whether the effort by NNS was deliberate and criminal or whether it was hard bargaining and should be viewed as merely a contractual dispute.

2. Examination of New Items

I was instructed to carefully examine two items that had not been investigated by previous grand juries: Discharge Sea Chests and Reactor Shielding. I also did some additional analysis of other items.

a. Discharge Sea Chests (Claim for $332,776)

This claim item relates to the system which discharges high velocity and high temperature cooling water from the reactor plant of the Class 38-40 cruiser. The claim covered three areas of alleged added work and cost: the change from steel to monel (a nickel/copper alloy), construction of a thermal sleeve as opposed to a waster piece, and whether weld joint numbers were required. I found some

I believe this item should be presented to a grand jury.

b. Reactor Shielding (Claim for $384,061)

This claim item relates to both the primary and secondary lead shielding surrounding the nuclear reactor of the Class 38-40 cruiser. The claim alleges that the Navy design was defective thus causing NNS to fabricate lead panels in a more expensive way. I found some [redacted] I also located a NNS letter (dated May 24, 1974) which cancelled previous NNS correspondence to the Navy; my interpretation of the documents is that NNS admitted its error and agreed not to seek an overrun (instead the claim item seeks $384,061 and does not even mention the May 24, 1974 letter). Documents have been examined showing that the Navy drawings clearly warned NNS of the danger of high temperatures; NNS apparently ignored the warning and should have to bear the cost. Although this item is complicated, I believe it should be presented to a grand jury.

c. Added Financing Costs (Claim for $107.3 million)

This item was submitted with regard to all 14 ships and is based on the time-value of money to finance work added by the government and the Navy's failure to make sufficient progress payments. The General

Accounting Office did an analysis of this item and concluded that NNS' calculations were off in that it did not allocate borrowings to each of the contracts; instead it used total shipyard-wide borrowings. In addition, the company used interest rates quoted by Chase Manhattan Bank and failed to account for lower interest rates charged by its parent corporation (Tenneco). Although I personally believe NNS showed a conscious disregard for the truth, court cases hold that contractors are entitled to financing costs. I do not believe additional investigation would be fruitful.

d. Navy Recruiting Practices (Claim for $23.7 million)

This item was submitted with regard to all 14 ships and is based on the Navy's recruiting effort in allegedly hiring skilled workers away from NNS. Previous investigation disclosed the thrust of the claim but did not uncover any specific instructions from high officials of the company to make up the $25,000/$35,000 figure to retrain new hires. One key witness who did a study for NNS has never been located. I believe this item has criminal potential.

e. Environmental and Safety Regulations

This item was submitted with regard to all 14 ships and is based on increased costs by NNS to comply with EPA and OSHA laws passed in the early 1970's. Mr. Silverstein and I found an FBI interview with the Navy contracting officer that indicates that the costs to comply with the legislation were never included in the original contract. Thus, NNS would legitimately have a right to seek added costs in a later claim for equitable adjustment.

f. Deterioration of Labor (Claim for $97 million)

This item was submitted with regard to all 14 ships and is based on the application of "Parkinson's Law" and the alleged government-caused delay causing NNS' labor inefficiency. Both the NNS claim and the Navy analysis agree that the psychological phenomenon of low worker productivity is impossible to measure. Notwithstanding that, the company simply assumed that each schedule change was government caused and figured a certain number of minutes per hour were wasted due to "deterioration of labor." The company could never prove a correlation between construction delay and decreased productivity. NNS also did not take into account contractor-caused delays not attributable to the government. I believe this item has criminal potential.

g. Deferred Work (Claim for $51.5 million)

This item relates to the added cost of work performed in a later and therefore higher cost period. It relates only to the Class 38-40 cruiser [Note: There may be other "deferred work" claims on the other 11 ships but I did not run across them]. The Navy does not deny that it owes NNS for added costs growing out of Navy-caused delays but it takes issue with NNS' calculations. A Navy accountant who analyzed this claim item concluded that the deferral of work did not cost nearly as much as NNS claimed — that the amount was $18.7 million not $51.5 million. The company used the inflation rate in 1971 when the contract was definitized instead of the actual lower inflation rate in 1975 when most construction took place. I do not know if additional investigation would be fruitful.

Set out method [illegible] [illegible] [illegible] deg. High [illegible] list. [illegible] change [illegible] month rate calculation [illegible] alternative for [illegible] [illegible]

3. Structuring An Indictment

I believe it is possible to structure an indictment along these lines: an overall conspiracy charged under 18 U.S.C. Section 286, specific counts on three "hard" items (Ventilation Control Air System, Discharge Sea Chests and Reactor Shielding) charged under 18 U.S.C. Section 287, and specific counts on at least two "soft" items (Navy Recruiting Practices and Deterioration of Labor) charged under 18 U.S.C. Section 1001.

Please inform me of the final decision in this matter.

cc: D. Lowell Jensen
Roger M. Olsen
Morris B. Silverstein

EXHIBIT Z

NOVEMBER 26, 1982 -- LETTER FROM MUNSELL TO OLSON

FILE COPY

United States Attorney
Eastern District of Virginia

701 Prince Street
Alexandria, Virginia 22314

703/557-9100
FTS/557-9100

November 26, 1982

ELM/chr

Roger M. Olsen, Esquire
Deputy Assistant Attorney General
Main Justice - Room 2113
Department of Justice
Washington, D.C. 20530

Re: Newport News Investigation

Dear Roger:

As I mentioned on the phone the other day, I am trying to keep you posted on what appears to be happening with this investigation--not because it is strictly my business, but because I may be in a position to observe. (I guess I also care because I am on record with the press as believing that the case was being adequately handled.)

As far as I know, only one lawyer is assigned to the case, and one FBI agent. All of the documents are here, but we see no concerted activity by people using them. A supervisory FBI agent commented to one of my assistants that he believed the agent was "winding the case down."

The statute of limitations will run on this matter in August of 1983. That is a very short time to put a case together. We seemed to agree last January that the matter warranted further investigation. That investigation doesn't seem to be taking place.

I hate to see a case of this potential magnitude go by default. The decision to bring an indictment is the Department's, of course. But, in my view, that decision should be based on a serious and committed effort to find out the facts on the claim.

We have staffed Litton, and are pursuing it as promised. I can't staff Newport News as well. I urge you to take a close look at the status of this investigation.

832

NNS-76

I know this is only one of many headaches you have--I'll try to keep you posted as much as I can. Have a good holiday season.

Very truly,

Elsie

Elsie L. Munsell
United States Attorney

cc: D. Lowell Jensen, Esquire
Assistant Attorney General

EXHIBIT AA

DECEMBER 16, 1982 -- MEMO FROM WEINER TO SILVERSTEIN

Memorandum

Subject Newport News Shipbuilding

Date December 16, 1982

To Morris B. Silverstein
Branch Chief, Fraud Section

C.C.W.

From Edward C. Weiner
Attorney, Fraud Section

Pursuant to your request, I have obtained the following files for you and Robert W. Ogren.

ACCORDIAN FILE A

5. Documents relating to statute problem (October 5, 1978 letters).

6. $600 million/$200 million Walsh notes.

7. OSHA/EPA file.

8. Deferred work file.

ACCORDIAN FILE B

9. Delay claim file.

10. Rickover letters regarding delay (Nimitz and Eisenhower).

11. Bound folder on delay (Nimitz and Eisenhower).

If you desire, I will compile a list

839

NNS-77

EXHIBIT BB

FEBRUARY 18, 1983 -- LETTER FROM RICKOVER TO OGREN

18 February 1983

Dear Mr. Ogren:

I am writing to you about the Newport News Shipbuilding Company investigation. I understand that as Chief of the Fraud Section of the Department of Justice, you are the Government official responsible for this matter.

I note that recent press reports, one of which is enclosed, state that the Newport News case is still under investigation. As you must know, I caused that matter to be referred to the Department of Justice some time ago by letter in 1978.

Recently, I expressed concern that the investigation was not being advanced (see "Report by the Comptroller General of the United States: Assessment of Admiral Rickover's Recommendations to Improve Defense Procurement" of 27 January 1983, a copy of which is enclosed).

My concern derived from reports given me by people on my staff who had access to the status report of the U.S. Attorney for the Eastern District of Virginia, promulgated in November 1981. This report indicated that Newport News Shipbuilding had violated Federal criminal law. This made your Department's apparent lack of action all the more frustrating to those of us who take seriously their oath, as Government officials, to preserve, protect, and defend the United States and its laws.

If press reports are accurate, and you have begun to move this case forward again, I shall be most gratified. Please advise whom you have assigned

(continued)

to this important matter and confirm that it is being actively pursued. If you are not the official responsible for this matter, please advise me at your earliest convenience who is, so that I may address my remarks to him.

Sincerely,

H. G. Rickover.
H. G. RICKOVER

Mr. Robert W. Ogren
Chief, Fraud Section
Criminal Division
U.S. Department of Justice
Constitution Avenue and 10th Street NW
Washington DC 20350

ENC

EXHIBIT CC

FEBRUARY 25, 1983 -- OGREN MEMO

Memorandum

Subject

Newport News Shipbuilding and Dry
Dock Investigation

Date

FEB 25 1983

RMO:RWO:eah

To D. Lowell Jensen
Assistant Attorney General
Criminal Division

From Robert W. Ogren
Chief, Fraud Section
Criminal Division

I. CRIMINAL DIVISION REVIEW.

In January 1982, the Criminal Division agreed to review and evaluate the extended criminal investigation of Newport News Shipbuilding and Dry Dock Company ("Newport News") that has been conducted by attorneys from the United States Attorney's office in the Eastern District of Virginia and from the Criminal Division and, to the extent that further investigation would be warranted, to undertake to complete that investigation. In April 1982, Edward C. Weiner of the Fraud Section was assigned to review the investigation and to make preliminary recommendations. Mr. Weiner's memorandum of August 5, 1982, contains the results of that initial review and recommends further investigation of certain items. Subsequently, at my request Mr. Weiner and Mr. Morris B. Silverstein have expanded the review to focus more precisely on the possible available theories on which criminal liability could be predicated, the evidence, if any, to support those theories, and potential avenues for further investigation.

835

NNS-78

I have met with Messrs. Weiner and Silverstein on a number of occasions to review the progress of our evaluation and have reviewed a number of transcripts, documents and other materials.

The evaluation process has now been completed. It is our recommendation that the Department of Justice decline prosecution and that no further investigation be conducted. That recommendation is based on the following conclusions:

1. Of the separate claim items that have been examined, only four (Discharge Sea Chest, Reactor Shielding, OSHA and EPA, and Ventilation Control Air System) appear to contain false claims or false statements.
2. None of those four, however, is prosecutable. There are adequate legal defenses which will make it virtually impossible to prosecute those items on a false claims or false statement theory.
3. The suggested use of an overall "conspiracy to defraud" theory (advanced both by the E.D. Virginia prosecutors and Mr. Weiner) would be, in our view, impossible under existing law and is largely inconsistent with the evidence developed during the six years of the investigation.

836

4. Devoting additional resources to attempt to continue this investigation cannot be justified, given the low probability that any prosecutable case will emerge.

II. THE CONTRACT, CLAIM AND CLAIMS PROCESS.

The five contracts which underlie this investigation involve the construction for the Navy of a number of nuclear powered vessels -- 7 submarines, 5 cruisers and 2 aircraft carriers --- over a ten-year period. The contracts were bid in the late 1960's and early 1970's, and the ships were built in the 1970's. Newport News received progress payments totalling approximately $2.5 billion dollars during the period of construction.

The type of contract involved in this procurement is known as a fixed-priced incentive contract. This type of contract provides for a variable profit to the contractor determined according to a formula that takes into account the extent to which the contractor's costs meet a target figure. In general, to the extent that costs are held down, the contractor's profit factor rises; to the extent they rise, profits are eroded. When cost overruns reach a predetermined figure, the contractor assumes full financial responsibility.

In August 1975, Newport News submitted a claim */ totalling approximately $50 million for equitable adjustments **/ covering certain items on the Class 688 submarines (the "Mini claim"). In March 1976, Newport News submitted a second claim seeking $894 million (the "Maxi claim") ***/ for overruns on the construction of all 14 ships. Twenty percent of the value of the items on the proposals for equitable adjustment involved hardware items. The remaining 80% consisted of soft items (*e.g.*, recruiting costs, financing costs, labor inefficiency, delays, etc.) The Navy ultimately settled these claims in two segments -- $41 million in February 1977; $167 million in October 1978 -- for a total of $208,000,000. It is the various aspects of these equitable adjustments that formed the basis of the subsequent criminal investigation.

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*/ Newport News argues strenuously that a proposal of equitable adjustment is only a bid or estimate and has not ripened into a claim under the Defense Acquisition Regulations. It argues, therefore, that the proposal for equitable adjustment is not a claim under 18 U.S.C. §287. That position is certainly questionable. We know of no authority supporting the Newport News argument.

**/ In its contract with Newport News, the Navy had the unilateral right to change the work to be performed. This "changes" clause entitled Newport News to equitable adjustment of the contract price and the delivery date whenever the Navy made or caused a change in the contract which resulted in an increased cost or time of performance. It also entitled Newport News to an equitable adjustment if the Navy failed to furnish specifications, drawings, or data in a timely manner.

***/ The Maxi claim in effect superseded the Mini Claim and incorporated those items of the Mini claim for which it sought equitable adjustment.

In 1974, the Newport News management established a separate unit - the Contract Controls Department - to prepare the overrun claims it intended to submit to the Navy. This massive effort was directed by C. Leonard Willis, who had at his disposal a large staff of over 200 people to prepare the 264 separate subsections to the overall claim. These Newport News employees researched and developed the proposal. Team leaders in Contract Controls directed various departments of Newport News to review their files to determine whether Navy action or inaction had caused significant time or cost increases. The team leaders then selected items for examination. These were assigned to personnel in Contract Controls who researched and drafted the claim proposals and wrote the narrative for each item. A separate department - the Cost Engineering Department - was responsible for determining the price of each item in the proposals. [Note - our investigation failed to reveal any evidence of interference with the pricing of the cost engineers or evidence of tampering with their figures]. When the claim proposals had been drafted they were reviewed by team leaders and by Willis, the department head. Newport News contends that 21 items were dropped from the carrier proposal and 94 items from the cruiser proposal as a result of this review. Many of the items were then submitted to Newport News' outside counsel Henry Beauregard and/or internal corporate counsel for review of the legality and basis of entitlement for each item.*/ The claim item was then reviewed by the company managers. In short, the process was one of decentralization of the research and writing process followed by joining the claims together for submission to counsel for review and to the Navy.

The claim that resulted from this effort was a multi-volume document. In addition, it is a highly technical document that as to certain items is extremely difficult to read or comprehend.

The Navy, confronted by the large scale claims and no adequate mechanism for dealing with them, responded by creating the Navy Claims Settlement Board (the "Board"). Ultimately, as noted above, the claims were settled for $208 million, the largest portion thereof being a $167 million settlement that occurred on October 5, 1978.

The claims negotiation process took two and one-half years. During that period, the Board evaluated in depth each of 264 separate claim items. A CITAR **/ or technical evaluation report for most of the claim items was prepared.

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*/ Newport News asserts that each item submitted to the Navy was reviewed by Beauregard. We are unable to verify this contention fully.

**/ CITAR is the acronym for "Claim Item Technical Analysis Report."

The result of this process was to reveal the shortcomings of the various claim items to a substantial degree. The Board identified 47 of the 264 plus items as potentially fraudulent. Unknown to Newport News, those 47 items as well as many other items were excluded by the Navy in determining the settlement figure. The Navy reached its final settlement figure of $208 million based on items whose legitimacy had not been questioned as potentially fraudulent. However, the final equitable adjustment reached did not identify which claim items or portions thereof were included within the settlement. Thus, it is not possible from an examination of the face of the settlement documents to determine if a particular claim in fact became a portion of the 208 million dollar recovery or if a particular claim theory was rejected.

In any event, in February 1977, the Navy settled the claims on 2 of the 5 cruisers for $41 million. On October 5, 1978, after a review by the Board, the Navy settled with Newport News on the remaining ships for $167 million.

III. THE CRIMINAL INVESTIGATION.

The history of this investigation is both long and tortured. As early as 1976, an attorney from the Criminal Division */ was designated to serve as liaison with the Navy regarding this matter. In 1976, the Navy initiated its

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*/ Calvin B. Kurimai of the Fraud Section.

investigation into the claim items identified during the Navy's technical analysis as potentially fraudulent. By letter dated, February 6, 1978, a copy of which is attached, the Navy General Counsel referred this matter to then Assistant Attorney General Civiletti for criminal investigation.

A grand jury was convened in October 1978 in Richmond and heard evidence regarding the Newport News matter until its expiration in April 1980. A second Richmond grand jury heard evidence until June 1980. The "Richmond" phase of the investigation was directed by Richmond Assistant United States Attorney Eliot Norman. Several Criminal Division and Navy Department attorneys were also assigned to the project. The Richmond prosecutors selected for investigation the 20 most promising of the 47 items viewed by the Board as potentially fraudulent. Over 4,850 pages of grand jury testimony were taken.

The "Richmond" phase concluded in October 1980 with a series of memoranda containing the recommendations of AUSA Norman joined by the Fraud Section Attorneys (but not the Navy attorneys) that the case be declined. The recommendation was rejected by then United States Attorney Justin Williams who assigned two Alexandria-based Assistant United States Attorneys, Joseph Fisher and Joseph Aronica, to continue the investigation.*/ Those Assistants conducted the "Alexandria" phase of the investigation (focusing principally on the "Ventilation Control Air System" claim item). The Alexandria investigation was concluded by mid-1981 **/. By late 1981, the prosecutors had prepared a 110-page "Status Report Re: Investigation of Newport News Shipbuilding claims for Equitable Adjustment." The report in substance recommended further investigation and concluded that a satisfactory prosecutive theory could be developed. The "Alexandria" status report focused principally on one claim item -- the Ventilation Control Air System -- and identified an additional 8 areas that it suggested could be investigated productively. Each of those items is addressed in this memorandum or in the appendix attached hereto.

During the "Alexandria" investigation an additional 1,300 pages of grand jury testimony were taken. According to Newport News, 86 former employees of Newport News have appeared before three separate grand juries and an additional 48 have been interviewed by the FBI.

In January 1981, the Newport News matter was turned over to the Criminal Division for review by the United

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*/ Assistant United States Attorney Norman entered private practice and was unavailable for the subsequent investigation.

**/ Witnesses testified before the grand jury in March and April of 1981. Some additional evidence was gathered in the next several months.

States Attorney's office.*/ Since then, the investigations to date have been reviewed by Edward C. Weiner, Morris B. Silverstein and Robert W. Ogren. The purpose of this review was to determine whether there is any realistic prospect for prosecution based on either new investigation or upon the extensive investigation conducted to date. As noted previously, the conclusion reached is that there is no reasonable prospect for prosecution.

The majority of our review has been based on summaries of the Alexandria prosecutors, Richmond prosecutors, CITARS, and other analyses of the claims item. In specific instances grand jury testimony or FBI 302's were also reviewed. The grand jury transcripts alone exceed 6,000 pages. The original claim is itself found in multiple bound volumes and the documents occupy dozens of file drawers and cartons in the Alexandria United States Attorney's office. Other source documents are located in a warehouse in Newport News. The potential number of witnesses is in the hundreds. The review undertaken has included an examination of all recommendations, relevant transcripts and statements, claims, CITARS and documents.

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*/ The reasons given by the Eastern District for referring the investigation to the Criminal Division included the following: (1) the office lacked the manpower or resources to continue the investigation, (2) Assistant United States Attorney Fisher had become Chief of the office's Civil Division, (3) the office was devoting extensive resources to the preparation of the Litton case for trial.

IV. POTENTIAL THEORIES OF PROSECUTION

The investigation stemmed from allegations that Newport News and its employees conspired and schemed to defraud the Navy regarding the equitable adjustment claims. The core allegation has been that the Mini and Maxi claims were false claims (18 U.S.C. §287) or false statements (18 U.S.C. §1001) prepared as part of an overall scheme or conspiracy to defraud by submitting false and inflated claims. At one time or another, each of the 47 separate claim items singled out by the Board have been viewed as possible false claims or false statements. A corollary allegation is that various letters and documents submitted by Newport News in the claims negotiation process subsequent to the submission of the Maxi claim renewed earlier false claims or contained false statements.

However, the conspiracy allegation has been expanded to include a second theory. This theory, suggested in the Alexandria prosecution report, is that Newport News and its employees conspired not simply to file false claims but to impair and impede the Navy's review process by submitting an indigestible quantity of claims based on non-meritorious entitlement theories. Put another way, under this theory Newport News targeted a goal of $200 million and deliberately submitted almost $900 million in largely inflated or non-meritorious claims with the expectation that the Navy would be so overburdened that in its futility it would end up settling for at least $200 million. (See Alexandria Report, p. 107).

We agree with the conclusions reached by the Alexandria prosecution team that it would be essential to a successful prosecution that we be able to prove that there was a conspiracy or plan to defraud the United States by filing false claims. Because of the central importance of that issue, the conspiracy theory will be discussed first.

A. CONSPIRACY

The "Alexandria" report suggests that the core theory for further investigation and prosecution should be an overall conspiracy in which Newport News submitted false or inflated claims or, in the alternative, deliberately submitted meritless claims (but not necessarily false claims) in such quantity that the Navy's review process was impeded and impaired. Another label for this theory is the "claims written backwards" theory. This set of assumptions posits that Newport News set a target dollar figure to recover in the equitable adjustment process and then drafted a series of claims designed to achieve that target figure without regard to the merits. There are a number of problems with that two-pronged conspiracy theory.

1. Conspiracy to File False Claims

The principal problem with a conspiracy to file false claims theory is, as will be discussed in subsequent portions of this memorandum, that it is not possible to prove any substantial portion of the various claims to be false. Only the Discharge Sea Chest ($332,766), Reactor Shielding ($384,061), Ventilation Control Air System

($989,000, but withdrawn) and OSHA ($5.5 million) claims have even a limited potential for being proven false. They represent in amount less than 1% of the Maxi claim and approximately 3% of the settlement total of $208 million. However, even with respect to these, there presently is neither evidence of specific intent, nor any evidence linking the falsity in such claims to an overall plan or conspiracy. See discussion of those claim items *infra*.

The false claim conspiracy theory also fails because its premise, that individual claim writers were told by Willis or other key officials to falsify or inflate claims, has not been substantiated by any credible witnesses.[6]

[redacted]

[redacted]

[redacted]

The Alexandria status report contains a five page section entitled "Evidence of a Massive Conspiracy to Defraud the United States." In that portion of their report the Alexandria prosecutors argue that the testimony of [redacted] supports the conspiracy theory they advance. In our view it does not.

Cardwell is, by all accounts of those who have spoken with him, a poor witness. He has a poor memory, does not incriminate Willis and in preparing his own claims apparently used accurate pricing. He will not testify that claim writers were instructed to prepare fraudulent claims. He has testified that a Willis subordinate, Billy Bridges, told him that if Newport News was to get $200 million it would have to ask for five times that amount. In a conversation with Mr. Weiner, Cardwell attributed the padding comment to a one-on-one conversation with Bridges. Cardwell, it should be noted, was laid off by Newport News and he admits to having a bias against the company.

The other potential conspiracy witness, Russell Weed, [redacted] Weed left the company in October 1974, 10 months before the Mini claim was filed.

[redacted]

[redacted]

An additional item of evidence claimed to support the conspiracy theory is the creation of the Contracts Controls Department. Frankly, absent some testimony indicating that it was created for a criminal purpose, we see no reason to conclude that its creation was anything other than a good faith effort to deal with a massive claims problem. It should be noted that the Navy itself had to create a special staff and office to process the claim.

Finally, which is said to support the second conspiracy theory directly undermines a conspiracy to file false claims theory. As noted more fully below (see pages 16-17 infra), the memorandum states

Given the present lack of evidence supporting the false claims conspiracy theory, and the abundant evidence contradicting it, the prospects are virtually nil that this theory could be developed with further investigation.

2. Conspiracy to Submit Voluminous Meritless Claims.

Both the Alexandria status report and Mr. Weiner's memo suggest that a conspiracy prosecution need not be based on proof that Newport News intended to file false claims in the classic sense. They suggest a novel conspiracy approach predicated on the theory that the shipyard intended to overload the Navy claims process (i.e, impede and impair that function with voluminous non-meritorious claims in an effort to cause it to break down). This theory assumes that the shipyard advanced claims based on frivolous entitlement theories which it knew were non-meritorious.

The theory has at least two problems. The first is that there is little evidence to support it, and as in the case of the conspiracy to submit false claims theory there is abundant evidence to contradict it.

The second problem is that there is, to our knowledge, no authority for predicating a conspiracy to defraud the United States by impeding and impairing its lawful functions on conduct that does not include a component of deception or trickery. Indeed, in the case most closely resembling this one, use of the conspiracy to defraud statute was expressly precluded. In Hammerschmidt v. United States, 265 U.S. 182 (1924), the Supreme Court drew a "trickery/deception" line for prosecutions under 18 U.S.C. §371. The Government had successfully prosecuted Hammerschmidt and others for conspiring to defraud the United States by "impairing, obstructing and defeating a lawful function of the government," that is military registration by circulating handbills counseling and urging non-registration. The Court held that the conduct in question while impeding and impairing the administration of the Selective Service Act involved no "deceit, craft, or trickery, or at least means that are dishonest" and therefore there was no offense.

There are a limited number of cases in which courts have found a conspiracy to defraud without stating the express requirement that there be proof of trickery/ deception. Significantly, however, in each case the government in fact proved a deception, false statements or a concealed corrupt act, *Haas* v. *Henkel*, 216 U.S. 462 (1910) (U.S.D.A. official bribed to obtain confidential crop information); *Dennis* v. *United States*, 384 U.S. 855 (1966) (use of false non-communist affidavits to bring NLRB into labor dispute); *United States* v. *Johnson*, 383 U.S. 169 (1966) (bribed congressman); *United States* v. *Shoup*, 608 F.2d 950 (3rd Cir. 1979) (Investigator altered investigative report and misled government in voting irregularities investigation to further personal ends).

In our view, the conspiracy theory suggested by the Alexandria prosecutors presents an insurmountable *Hammerschmidt* problem. As to virtually all of the so-called soft items, the issue is not one of non-disclosure or deceit but of entitlement, that is, the facts and theory of recovery are set out in the claim and the government's position is that there is no legal basis for the claim.

B. FALSE CLAIM-FALSE STATEMENT.

As noted previously, the operating premise of the investigations to date has been that certain of the claims are false. It is our conclusion, however, that few of the claims identified as questionable can be proven false.

A prosecution under the False Claims Statute, 18 U.S.C. §287 requires the Government to prove (1) making or presenting to the Navy (2) a claim against the United States (3) with knowledge (4) that the claim is false, fictitious, or fraudulent. At least one court has read into the False Claims statute the element of materiality. *United States* v.

Johnson, 284 F.Supp. 273 (W.D. Mo. 1968), aff'd, 410 F.2d 38 (8th Cir. 1969). More significantly, the Fourth Circuit, in dictum, has recognized the existence of a materiality requirement in false claims prosecutions. United States v. Snider, 502 F.2d 645, n. 12 (4th Cir. 1974).

A prosecution under the False Statement Statute, 18 U.S.C. §1001, would require the government to establish essentially similar elements.

Finally, it should be noted that in the unique context of a corporation committing the offense of false statement, the Government has the obligation to prove that knowledge of the falsity was centralized in one officer or employee. N.Y. Central and H.R. Rail v. United States, 212 U.S. 481 (1909); Imperial Meat Co. v. United States, 316 F.2d 435 (10th Cir. 1963); Continental Banking Co. v. United States, 281 F.2d 137 (6th Cir. 1960).

1. Is There a Claim or Statement within the Statute of Limitations?

To the extent that false claims or false statements are contained in the September 1975 Mini claim and the March 1976 Maxi claim, they are barred by the statute of limitations. The only non-time barred theory available to prosecute Newport News would be that several letters sent in 1978 by Newport News to the Navy in connection with the settlement negotiations in effect renewed the Mini and Maxi claims and are either false claims or false statements. The Alexandria prosecutors argue that the letters are enough,

853

basing their conclusion on the District Court's ruling in Litton [*] that an offer of settlement is a claim within Section 287 and on the Fourth Circuit's opinion that did not discuss the issue. United States v. Litton Systems, Inc., 573 F.2d 195, 196 (4th Cir. 1978). However, we doubt that a court would allow the Government to revive an otherwise time barred claim for statute of limitations purposes each time a new letter is submitted to the Navy prior to obtaining payment. If not, then prosecution would be barred under the false claim statute.

A second issue is whether the two 1978 letters are "claims" or "statements". Clearly, the letters themselves are not couched in claim language. The first letter, dated April 20, 1978, referred primarily to financing costs but further stated that the Newport News review "of other requests for equitable adjustment had disclosed no major errors or inconsistencies." A second letter, dated October 5, 1978, (which is one of a group of similar letters bearing the same date) concerned 3 nuclear powered guided missile cruisers (CGN 38, 39 and 40) and stated "during the continuing review and negotiation subsequent to the submission of the proposal, the Company discovered no

854

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[*] United States v. Litton Systems, Inc., d/b/a Ingalls Nuclear Shipbuilding Division, Crim. No. S78-00031(R) (S.D. Miss.)

instances of inaccuracy. In each instance in which inaccuracy could have affected pricing, the Company advised the Navy of the error."

It is doubtful whether these assertions could be called "claims". However, clearly they are statements which if false potentially could be prosecuted. Were a prosecution predicated on the theory that these assertions were false, it would be necessary to prove, as to the April 20th letter, that Newport News' review of the requests for equitable adjustments in fact disclosed major errors or inconsistencies and, as to the October 5th letters, that Newport News was aware of and had knowledge that there were errors or inaccuracies and further had knowledge that it had not advised the Navy of errors in the instances in which inaccuracies could have affected pricing.

Of course, attempting to formulate a prosecutable false statement case from such a general, non-specific statement is a formidable task under the best of circumstances. In the context of the proof problems of this case, to be discussed below, it appears insurmountable.

It should be noted, however, that even if the statute of limitations has run on either a false claims or false statement theory, it probably has not run on a false claims conspiracy (18 U.S.C. §286) or conspiracy to defraud the United States (18 U.S.C. §371).

2. Was the claim/statement false, fictitious or fraudulent?

Two hundred sixty-four separate claim items were submitted to the Navy in the proposals for equitable adjustment. However, the universe of potentially false claim items that we have reviewed is that suggested in the Alexandria status report plus several that we regarded as worthy of reexamination. In each instance the allegation of falsity has been analyzed in light of the evidence and potential defenses. A summary of the merits (or lack thereof), of each item is set forth in the Appendix to this memorandum. Suffice it to say, that there is virtually no criminal prosecutive potential to 10 of the 14 claim items. After countless hours of investigation and review by the Navy (whose analyses were at times lengthier than the claim item itself), 3 grand juries hearing more than 6,000 pages of testimony, interviews of more than 100 Newport News employees, 2 extensive prosecution reports from both the Richmond and Alexandria investigations, and 5 years of criminal investigation, it is our view that there are only four items that even arguably can be proved false; and one of 'those was withdrawn prior to settlement and the three others have not been investigated and on their face are subject to technical attack. Moreover, 2 would present technical issues that would test the limits of a jury's capacity to comprehend the proceedings.

(a) The Ventilation Control Air System claim.

This $930,000 item was arguably false */ in claiming that the Navy's design specifications used to bid the contract were "vague and ambiguous." This item was extensively investigated by the Alexandria prosecution team which appears to have developed solid proof that the design specifications were clear and unambiguous. However, investigation to date has not established which Newport News employees, if any, knew that the specifications were not "vague and ambiguous", knew of the language in the claim and also assisted in submitting this item to the Navy. The individual most likely to have had that knowledge, if anyone, was Willis,

In addition, the prosecutive potential of this claim item is substantially weakened since it was withdrawn from consideration by Newport News on September 26, 1978, prior to the October 5, 1978, reaffirmation letters and is not material to any post-September 26, 1978, Navy actions, including payment of the claim. Prosecution of the Ventilation Control Air System item would have to be based on the April 20, 1978, letter to the effect that the Newport News review of the equitable adjustment disclosed no major

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*/ A more detailed discussion of this item and items (b), (c) and (d) appears in the Appendix hereto.

errors or inconsistencies. As discussed above, we have serious doubt whether the Government could meet this burden. Moreover, the withdrawal of the item in September, 1978, the defense could assert, was consistent with a good faith approach to the claims process. At best, we would have a technical violation, which standing by itself has no prosecutive merit.

(b) Discharge Sea Chest.

This $300,000 item holds some potential for being proven to be fraudulent. The Newport News claim in essence was (a) that the required use in construction of monel (a nickel/copper alloy) rather than steel to build the Discharge Sea Chest was unanticipated; and (b) that the use of thermal sleeves rather than waster pieces was also unanticipated. There is evidence indicating that the required use of monel and thermal sleeves was communicated to Newport News by the Navy before it bid on the contract. The details of this item have not been investigated.

Notwithstanding the apparent inaccuracy of the Discharge Sea Chest claim, there are technical problems which would preclude a prosecution predicated on this item, even assuming otherwise sufficient evidence were developed in further grand jury proceedings.

In 1974, Newport News asked the Navy for a contract adjustment to cover additional costs it claimed had been incurred in building the Discharge Sea Chest. In the fall of 1974, the Navy completed an extensive review of the matter and denied Newport News' request. In its 1976 Maxi claim 2 years later, Newport News reiterated its prior position. At a minimum the Navy's rejection in 1974 of the same item later submitted in a different request could arguably preclude that item from being "material" to the Government in a false claim prosecution.

In both the Ventilation Control Air System and the Discharge Sea Chest items, Newport News could also argue with some merit that the contract specifications were ambiguous and susceptible to the interpretations embodied in its claims. The Government would be required to prove beyond a reasonable doubt that the interpretation of Newport News was unreasonable. United States v. Race, 632 F.2d 1114 (4th Cir. 1980).

(c) Reactor Shielding

This $384,000 claim item has an extremely limited potential for ultimately being shown to be fraudulent or deceptive. It is an exceptionally complex, technical claim item and has not been investigated by either the Richmond or Alexandria prosecution teams.

The potential false claim or statement, if any, is Newport News' claim for additional costs due to an inadequate design that caused fabrication problems. */ The

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*/ "Reactor shielding" relates to the primary and secondary lead shielding surrounding the nuclear reactor for the Class 38 Series Cruisers.

Navy lays the blame for the design problems at Newport News' door arguing that the problem had occurred earlier and was the result of manufacturing errors.

At this juncture virtually nothing is known about the claim preparation process for this item. For example, we do not know who prepared the claim, what documents were reviewed, or what if any instructions were given.

Even assuming a culpable claims writer could be identified, there are insurmountable problems to turning this item into a prosecutive vehicle. The amount of the claim item is comparatively insignificant. The subject matter and nature of the dispute is extremely complex and technical. Ultimately, the government's burden would be to show that Newport News' interpretation of the design was unreasonable. This appears a hopeless task.

(d) OSHA and EPA

This 5.5 million dollar claim item was advanced by Newport News on the theory that it was entitled to additional overhead because as an unforseen circumstance, Congress enacted OSHA and several environmental Acts, which increased its costs. The alleged false statement is that in its claim filed seeking equitable adjustments Newport News stated in substance that during the contract negotiation process, no consideration was given in the 1970 proposal to the impact of OSHA or the environmental acts. In fact in a 1971 supplemental proposal, the impact of OSHA and EPA legislation was raised by Newport News.

Notwithstanding the apparent falsity of the claim items, even this item presents technical problems that could well prove insurmountable. At a minimum, the representation to the Navy may be literally true. In any event, this item has received no investigation to date.

3. Intent

The Fourth Circuit requires the Government to prove that the party submitting a false claim has knowledge of the falsity of the claim plus a consciousness that he was doing something which violated the law. Proof of reckless indifference or disregard as to the truth or falsity of a statement is not enough. The party submitting the claim must act with the specific purpose to violate the law or act with the awareness that what he was doing was wrong. United States v. Maher, 582 F.2d 842 (4th Cir. 1978).

No evidence has been developed to date which points to a specific high level official or employee of Newport News possessing the necessary specific intent to submit false or fraudulent claims. The evidence developed in this investigation with regard to the claims writing process and the submission of the claim items does not prove the consciousness or awareness that the Fourth Circuit requires. The circumstances under which the claims were created tend to support the view that the claims preparation process was not fraudulent.

First, the claims process as set up and operated gives the appearance of integrity and of an adequate mechanism to insure the accuracy of the proposals. The research and claims writers were separate from the cost engineers who priced the proposals. We know of no evidence which shows interference with the pricing done by the cost engineers or tampering with their figures. The overall process of decentralizing the claims writing among 200 plus contract specialists and the reassembling of the claims suggests proper controls were present. The review process which eliminated more than 120 items suggests a weeding out of dubious claims. The repeated referrals to attorney Beauregard for legal sufficiency and a proper theory of entitlement again suggests a good faith procedure of internal controls and review. It also provides in several clear instances an advice of counsel defense. In fact, the entire process suggests on the surface that Newport News was trying to submit only valid claims.

Second, the motivation to submit accurate claims is readily apparent. Newport News employees had the perception that Admiral Rickover intended to accuse Newport News of fraud.

This may have resulted in dubious theories of entitlement but such are not a valid basis for false claim prosecutions. The evidence, tending to show good faith throughout the claims process, negates specific intent to defraud.

Third, in a limited prosecution of 2 or 3 claim items, the Government would be in the anomalous position of arguing that intent to defraud is present although the extent of the fraud we could establish would at most be two or three fraudulent items out of 264 claim items totalling no more than $6 million out of a $894 million proposal for equitable adjustment.

Finally, it is revealing to consider what the investigation has not found. There is no evidence of fictitious manhours, double billings, phony vouchers or the passing off of old parts for new parts. In short, there are virtually none of the normal indicia of fraud.

V. MISCELLANEOUS MATTERS

The purpose of our review of course has been to evaluate the evidence developed to date. However, that review has raised issues that will have an impact on this matter during any further investigation or in a criminal proceeding.

A. PRE-INDICTMENT DELAY.

Newport News has complained bitterly about the length of the investigation and its stops and starts. That complaint was crystalized in a "Motion to Quash, to Enjoin the Grand Jury and for Return of Records" filed by Newport News in 1981, when the Alexandria phase of the investigation began. At the oral argument on that motion before Judge Merhige, Newport News counsel spelled out its assertion of prejudice in some detail. Judge Merhige denied the Motion, but noted rather pointedly that were the issues presented in 1982 or 1983 rather than Spring 1981, his attitude might well be different. (See In re Grand Jury Investigation, CR 78-0038-A-R E.D. Va. Transcript dated April 22, 1981, pp. 26-31). Clearly an all out assault on a renewed investigation can be expected, with time consuming motion practice and, quite probably, with the Government in the position of being required to justify the delays in this investigation.

B. THE "RICKOVER" OR "AXE TO GRIND" DEFENSE.

Whether in the context of grand jury practice or trial, the next round of litigation in this matter is likely to inject the "Rickover" issue in some fashion. Simply put, this issue is Newport News' contention that the Navy "has a potential interest in the return of an indictment" (Newport News Submission, p. 8.) That interest, it is contended, is fueled by the Navy's own failures and misconduct in handling the procurement.

The tenor of that testimony at trial will be that Newport News fully expected to be accused of fraud by Admiral Rickover regardless of the merits of its position with respect to the equitable adjustments.

The second formulation of this defense is set out in the detailed allegations contending that Admiral Rickover improperly interfered in the performance of the contract

(See Section IV of the Newport News submission) in a number of respects. The submission makes numerous specific allegations of threats and other alleged misconduct by Rickover that can be expected to be raised at every juncture should this matter proceed.

C. PRICE AND QUALITY.

There appears to be no question that Newport News produced ships of acceptable quality. It is also clear that the final sum paid as an equitable adjustment ($208 million) is regarded as fair by relevant Navy officials.

D. ADDITIONAL RESOURCES.

In our view, the prospects are virtually nil that a prosecutable case can be developed. Were one to take the position that further investigation is appropriate, however, the resources necessary to be brought to bear in such an effort are truly staggering. We would not recommend the commitment of valuable and scarce attorney resources to a venture with such a low to non-existent probability of success.

Our assessment of the manpower required is that at a minimum 3 or 4 full time trial attorneys would be needed. Extensive investigative support also would be necessary. The focus of the team would be to reinterview witnesses and represent testimony of an extensive group of Newport News employees and former employees in the hope of developing testimony consistent with the theory that Newport News attempted to jam the equitable adjustment process to obtain an unjustified settlement.

In addition, the investigation would focus on the two uninvestigated technical claims relating to Discharge Sea Chest and Reactor Shielding.

E. CONCLUSION

It is our recommendation that prosecution be declined and the investigation terminated at this time.

Attachments

998

cc: [illegible]

SENSITIVE - HOLD CLOSE

6 February 1973

Honorable Benjamin R. Civiletti
Assistant Attorney General
Department of Justice
Criminal Division
Washington, DC 20530

Jack (

Dear Mr. Civiletti:

Allegations have been made, both in the Congress and the media, that cost overrun claims for Navy ship construction by the Newport News Shipbuilding and Drydock Company may be false or fraudulent. These contracts involve several classes of ships constructed over the past ten years.

As a result of these allegations, members of the Office of the General Counsel, under the leadership of Ms. Saundra Adkins, have investigated the claims and, during the course of their review, have discussed them informally with Mr. Calvin Kurimai of your Criminal Fraud section. At this time, Ms. Adkins' investigation of certain of the allegations has been completed; and summaries of her findings are being forwarded to Mr. Kurimai under separate cover. The documentary evidence supporting these summaries is quite voluminous and is available at your request. Ms. Adkins will also serve as the point of contact within the Office of the General Counsel on these matters if any additional information or assistance is needed; she can be reached at 692-1164.

The Navy is continuing its review of other allegations against Newport News, and it is anticipated that additional matters will be forwarded to your office for action in the near future.

867

Sincerely,

[illegible]

Prepared by: M. F. Marino,
Special Assistant to the

APPENDIX

1 - 43

Index to Appendix

A. Discharge Sea Chest - App. 1

B. Reactor Shielding - App. 6

C. Bow Dome - App. 9

D. Cathodic Protection - App. 12

E. Copper Nickel Tubing - App. 15

F. Intermediate Gauge Cutout Valves - App. 16

G. Ventilation Control Air System - App. 18

H. Nimitz Delay - App. 22

I. Eisenhower Delay - Shipway Utilization - App. 24

J. Eisenhower Delay - Innerbottom Shielding - App. 26

K. Added Interest or Finance Charges - App. 28

L. Recruiting Claims - App. 31

M. Fictitious Manhours - Deterioration of Labor - App. 36

N. OSHA and EPA Claims - App. 39

A. Discharge Sea Chest ($332,776) (Section 5.29 of the proposal for the Class 38 Series Cruisers)

Discharge Sea Chests are openings in the ship's hull from which high velocity and high temperature cooling water from the reactor plant of the Class 38-40 cruisers are discharged to the sea. The claim covers three areas of alleged added work and cost: the change from steel to monel (a nickel/copper alloy) as construction material; the use of a thermal sleeve instead of a waster piece (steel protection sleeves); and whether weld joint numbers were required. This matter was not investigated by either the Richmond or Alexandria prosecution teams.

Monel/thermal sleeves

Newport News represented in its claim that it encountered added work and increased costs in connection with the sea chests which were not contemplated at the time the contract was entered into in October, 1971. Newport News asserts that it was misled by defective Government specifications and bid package data and therefore did not anticipate that the sea chests on the Class 38 Series Cruisers were to be of monel and contain thermal sleeves instead of lower cost steel and waster pieces used on the Class 36 Series Cruisers.

The specifications stated that the sea chests for the Class 38 Series Cruisers "unless otherwise specified shall be fabricated from the same material as the hull plating".

The specifications for the Class 36 Series Cruisers specified the sea chests were to be made from steel plates. Newport News also claimed that it was not until it reviewed working drawings (no deviation was permitted from them) and guidance drawings (illustrative but not mandatory) after its bid date that it realized that monel and thermal sleeves were required.

The Navy CITAR points out several reasons why Newport News position is wrong. First, Newport News had concurred in the use of thermal sleeves and monel for the aircraft carrier Enterprise in October 1969 to minimize the effects of corrosion and was therefore aware of their use. Second, the guidance drawing furnished Newport News in November 1969, and other working drawings furnished Newport News in the two months prior to the conclusion of contract negotiations clearly indicated monel and thermal sleeves would be required. Third, the specifications indicated that working drawings would follow which later drawings did refer to thermal sleeves. Fourth, Newport News took no exception until 1974 to the use of monel and thermal sleeves. Fifth, in May, 1974, Newport News informed the Navy that it had "overlooked" the change from steel to monel in its bid and that the additional cost for this item and thermal sleeves would be furnished the Navy. (In the 1976 Maxi-claim, the "overlooked" language was omitted). In October, 1974 the Government answered Newport News and set forth its chronology of events stating that Newport News knew or should have known of the design change (monel and thermal sleeves) for the sea chests when it bid the sea chests for the Class 38 series cruisers.

The Alexandria prosecutors contend that Newport News' claim that its cost overruns were due to deficient specifications is false. Newport News contends, however, that this is merely a contractual dispute concerning the interpretation of contractual drawings and specifications Consequently, the Government would have to prove beyond a reasonable doubt that their interpretation is not a reasonable one. There has been no investigation focusing on the preparation of the claim, whether the working drawings and guidance drawings were reviewed by the claim preparer, or what instructions were given to the claims preparer. Therefore, we presently have no evidence of the identity of the prospective defendant or target or evidence of fraudulent intent.

We would also expect Newport News to argue that this item could not meet the "materiality test" required by 18 U.S.C. 287 or 18 U.S.C. 1001. The test for materiality is whether the statement or the omission of it has the natural tendency or was capable of influencing the decision of the Navy on this item in the proposal for equitable adjustment (18 U.S.C. 1001) United States v. Weinstock, 231 F.2d 699, 701 (C.A.D.C. 1956); (18 U.S.C. 287) United States v. Snider, 502 F.2d 645, N. 12 (4th Cir. 1974). The Navy was aware of Newport News' position on this item in 1974 and had rejected it at that time. Therefore, it is arguable that the 1976 submission of this item was incapable of influencing the Navy's decision.

In addition, it is doubtful that this item could serve as a basis for a false statement prosecution under the October 5, 1978 letter which states merely that Newport News had informed the Navy of any inaccuracies it had discovered. There is no evidence of inaccuracies that Newport News had discovered after submission of the Maxi-claim but failed to reveal to the Navy. 1/

1/ A false statement theory would also fail if based on the failure to inform the Navy in the 1976 Maxi-claim that Newport News had informed the Navy in May, 1974 that it had "overlooked" the change from steel to monel and the additional cost for thermal sleeves in its bid (assuming that there is not a statute of limitation problem). Any false statement prosecution (18 U.S.C. 1001) based upon concealment or cover-up requires that such concealment or cover-up be done by a trick, scheme or device. There is no evidence to suggest a trick, scheme or device other than the argement that Newport News was engaged in a conspiracy to defraud the Government by overloading the claims process to obtain more money through filing of items which they had previously withdrawn or rejected. As discussed in the main body of the memorandum, there is no case precedent for this theory.

Weld Joints

Newport News claimed that welding instructions regarding the Discharge Sea Chest were vague, unclear or incomplete in specifying that each weld was to be numbered for inspection purposes. As a consequence, Newport News claimed that it had to later redo the welds once it was determined weld numbers were needed since welds with numbers must meet more stringent requirements.

The Navy's response is that the shipbuilder is not prohibited from adding his own weld numbers and the presence or absence of weld numbers on Navy drawings in no way modifies the inspection requirement. This issue is strictly a dispute dependent on the interpretation of the specifications and contract documents. There is no evidence of falsity although the drafts of the Cost Engineering Department recommended eliminating the "Weld Joint" portion of the claim item.

B. Reactor Shielding ($384,061) (Section 5.2.5 of the proposal for Class 38 Series Cruisers)

"Reactor shielding" relates to the primary and secondary lead shielding surrounding the nuclear reactor for the Class 38 Series Cruisers. This matter was not investigated by either the Richmond or Alexandria grand juries.

Newport News' claimed additional costs due to an inadequate Government furnished design which caused problems in fabrication and installation of lead and polyethylene shielding in the reactor plant since the design did not make sufficient allowance for heat dissipation. The shipyard's position was that it took the initiative to solve the problem; that the fabrication methods required by the Government design were extremely costly and time consuming; that the problems could not have been perceived at the time the contract price was established.

The Navy's position is that the contractor failed to adequately plan the fabrication process and to schedule adequate performance time. Therefore, the contractor had to propose alternate techniques to reduce cost and performance time. The change in the design was allowed only for the convenience of the contractor. The Alexandria prosecutors conclude that Newport News' problems had nothing to do with defective specifications but with the fact Newport News' prior experience should have made them aware of the problems with excessive heat.

The contract was entered into in late 1970. The design problem was recognized by the contractor in late 1972. From then through mid-1974, there were nearly two dozen written communications between the Navy and Newport News regarding the design problem. It was not until March, 1974, however, that Newport News first indicated the design specifications were defective and that the additional work might not be within the scope of the contract. On April 9, 1974 Newport News told the Navy (Supervisor of shipbuilding at Newport News) that they were proceeding to do the work even though they disagreed that it was their responsibility. Newport News indicated that they would submit a proposal for equitable adjustment. In May, 1974 Newport News cancelled the April 9th letter.

The Alexandria prosecutors contend that there was a possible fraud in the claims write-up regarding the conclusions that the problems resulted from defective specifications rather than Newport News technical mistakes. This item is an extremely technical one which relies heavily on technical analysis of what was called for by the specifications (the bonding of lead shielding to the steel honeycomb structure that forms shield bulkheads).

There has been no investigation focusing on the preparation of this claim item, what documents were reviewed by the claims preparer, or what instructions were given to him. Therefore, we presently have no evidence of fraudulent intent.

Assuming a thorough and detailed investigation were conducted into this $384,000 item, it seems unlikely that a dispute over the adequacy of design specifications could possible be made comprehensible to a court and jury. The Government would have the burden of proving beyond a reasonable doubt that the Newport News interpretation was not a reasonable one. [2]

In addition, it is doubtful that this item could serve as a basis for prosecution as a false claim or false statement under the October 5, 1978 letter which states merely that Newport News had informed the Navy of any inaccuracies that it had discovered. There is no evidence of inaccuracies that Newport News discovered but failed to reveal to the Navy after submission of the Maxi-Claim.

2/ Another allegation of falsity raised during the course of the review is the omission from the Maxi-Claim of the fact that Newport News had formally cancelled its April 9, 1974 letter in which it denied responsibility. In its Maxi-Claim, Newport News refers to much of the other correspondence between it and the Navy during the late 1972 to mid-1974 time period but omits reference to the cancellation. This allegation of falsity appears to be of little or no consequence.

The same arguments would be applicable here as applicable in the Discharge Sea Chest claim item and Newport News failing to inform the Navy in the Maxi-Claim that it had told the Navy previously that it has "overlooked" certain items. These arguments are lack of materiality and lack of a false statement since there was no concealment by trick, scheme or device.

C. Bow Dome ($75,000) (Section VII.B.8 of the proposal for the Class 688 series submarines)

When Newport News submitted its "mini-claim" proposal to the Navy in June, 1975, it claimed that it had incurred additional costs due to a design change for attaching the glass reinforced plastic bow dome to the hull of the Class 688 submarines. The dome contains the hydrophones that provide the submarines with sonar capability. Newport News contended that the Navy had changed the method of attachment from the welding method which Newport News had bid on to a bolting method of attachment.

878

[redacted]

The claim narrative for this item was not reinserted in the Maxi-Claim submitted to the Navy in 1976 as it was written in the Mini-claim. The claim as redrafted makes no reference to the nature of the bid. The claim as redrafted identifies the difference between the Navy's contract guidance drawings and the working drawings governing installation and asks for an adjustment representing the difference.

879

On October 4, 1978, Newport News informed the Navy for purposes of complying with the Truth in Negotiation Act that its review had determined that a design calling for a bolting method of attachment was included in the bid proposal. The letter did not withdraw the Bow Dome item from consideration but stated that further review would be conducted of this item to determine any affect on the overall proposal. The settlement took place the next day.

The Richmond prosecutors devoted 50 pages of their report to this issue. Although Beauregard did not testify before the grand jury, The Richmond prosecutors concluded that there was no false statement in the Maxi-claim with regard to this item and that there was a good faith reliance on advice of counsel. The Alexandria prosecutors conclude that the rewritten claim contains material omissions of fact and state a spurious theory of entitlement. In essence, they argue that there was a criminal offense committed by the failure to withdraw the Mini-claim once the true nature of the bid was uncovered.

We agree with the Richmond prosecutors that the good faith reliance on the advise of counsel defense would preclude prosecution based on any false statement or false claim theory. In addition, since Newport News had informed the Navy of the previous inaccuracy in the October 4, 1978 letter, there can be no false statement prosecution based on the October 5, 1978 letter in which Newport News asserts that it had told the Navy of each inaccuracy that it had discovered.

b. Cathodic Protection ($194,000) (Section VII.B.9 of the proposal for the Class 688 series submarines)

Cathodic Protection is the installation of zinc to the hulls of the Class 688 submarines for protection against salt water. The matter was investigated

and was the subject of a 25 page prosecutive report.

Newport News claims in the Mini-Claim that both the quantity and method of attachment of the zinc to the hull were changed by the working drawings after Newport News bid the contract. The inference is that Newport News bid the contract based on historical data from prior ships (Class 637 submarines) but thereafter working drawings changed the requirements. Any false claim theory would have to be based on proof that the specifications were clear and that Newport News, knowing them to be clear, claimed otherwise. Whether the specifications required a particular method of attachment is a matter of interpretation according to one Navy analyst.

[redacted]

In July, 1978, this item was again reviewed by Newport News after hiring of new outside counsel and it was determined again that the installation method for the Class 688 submarine was the same as for the Class 637 submarine. On October 4, 1978, Newport News informed the Navy for purposes of complying with the Truth in Negotiation Act that its review had determined that the installation method was the same for both classes of submarines. The letter did not withdraw the Cathodic Protection item for consideration but stated that further review of this item would be conducted to determine any affect of the overall proposal. The settlement took place the next day.

The Richmond prosecutors concluded in their 24 page memorandum on this issue that the decision to make the claim "had some reasonable basis, even though in error."

They summarize that from their review a successful indictment on this item would be "extremely difficult."

The Alexandria prosecutors argue, as in the Bow Dome item, that the rewritten claims contained material omissions of fact and state a spurious theory of entitlement. They contend that a criminal offense was committed by the failure to withdraw the Mini-Claim after Newport News became aware there was no basis for claiming that the installation methods were different. The Alexandria prosecutors contend the crime was compounded when Newport News reworded their narrative to inject ambiguity into the discussion of the 688 class specifications and their knowledge of the absence of historical data on the Class 637 installation method.

We agree with the Richmond prosecutors that good faith reliance on the advice of counsel would preclude prosecution based on any false statement or false claim theory. In addition, since Newport News had informed the Navy of the previous inaccuracy in the October 4, 1978 letter, there can be no false statement prosecution based on the October 5, 1978 letter in which Newport News asserts that it told the Navy of each inaccuracy that it had discovered.

E. Copper Nickel Tubing ($600,000) (Section VII.D.8. of the proposal for the Class 688 series submarines)

Newport News filed a Mini-Claim for the Class 688 submarines which included pricing figures for Copper Nickel Tubing. When DCAA auditors reviewed the matter in 1975, they were not told that this item had been repriced and that it was overpriced in the Mini-Claim by $600,000. The actual pricing was not provided until March, 1976 when the Maxi-Claim was filed.

The Richmond prosecutors concluded that there was lack of proof of criminal intent for several reasons.[3] All parties knew that revised current pricing data would be supplied prior to the settlement of the Mini-Claim. They knew that several items had been deleted at the Navy's request and others slashed in an effort to reach a quick settlement. They knew that there were several underpriced items and that the Mini-Claim was underpriced by $2-3 million.

Since there is no evidence that this item was inaccurate in the Maxi-Claim filed in 1976, this item could not serve as a basis of a false claim or false statement prosecution based on that filing or on the October 5, 1978 letters.

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[3] This item was not raised by the Alexandria prosecution team as meriting further investigation.

F. Intermediate Gauge Cutout Valves (Section 3.2.11 of the proposal on the Nimitz and Eisenhower carriers)

The claim item states that in 1973 the Navy design agent required the addition of 124 valves not called for in the ship specifications. Newport News requested reimbursement for this additional work. The requirement for the valves was actually added in 1968 or 1969 prior to the contract being signed.

the item was withdrawn on February 1, 1978. Therefore, in their October 5, 1978 letters to the Navy, Newport News is factually accurate when it states that in each instance in which they discovered an inaccuracy that affects pricing, they have notified the Navy.

4/ This item was not raised by the Alexandria prosecution team as meriting further investigation.

Since this item was withdrawn in February, 1978, it cannot serve as the basis for a false claim or false statement prosecution based on the October 5, 1978 letters.

G. Ventilation Control Air System ($989,000) (Section 5.2.8 of the Proposal for the Class 38 Series Cruisers)

The ventilation system on the Class 38 cruisers brought in cool air from the outside, cooled the nuclear reactor compartment and exhausted the heat through the stacks. The reactors, ventilation control air system (VCAS) provides air for pneumatic control of the valves and other components in the ventilation system. The VCAS has been analogized to the electric power which operates the fan (ventilation system).

This matter is the major item discussed in the Alexandria Status Report. The matter was also investigated by the Richmond prosecutors. The Richmond prosecutors concluded that probable cause did not exist to base an indictment on this item. The Alexandria prosecution team concluded, however, that this individual claim is not only false and without legal merit, but that its preparation was purposeful and criminal.

In this claim item, Newport News represented that it was misled by the contract specifications, contract guidance drawings, and the lack of other design data during the bid protess on this item. Newport News claimed in particular that the contract guidance plan was "vague and ambiguous". As a result, when Newport News prepared its contract proposal, it underbid this item by about $1 million.

Newport News contends that it thought it was building a VCAS for the Class 38 cruisers which was similar to that for the Class 36 cruisers except for a more complex high pressure system.

The VCAS for the Class 38 series cruiser was a brand new system designed to service the upgraded reactor plant ventilation system. The Alexandria prosecution team contends that Newport News "blew it" when the item was bid; that the item fell through the cracks.

Newport News contends that it based its claim on the contract specifications which asserts that the reactor plant for the Class 38 series shall be "similar to those provided" in the Class 36 series. They contend that the contract specifications did not include a requirement for the VCAS. Moreover, they argue that non-mandatory guidance drawings which discuss the VCAS refer to "fluid" systems and that the pneumatic system was not a fluid system but rather an "air or gas" system. The guidance drawings furnished Newport News show that the Class 38 series required more, numerous, bigger and more complicated valves than the Class 36 series.

The Alexandria prosecution team concluded that Newport News must have been aware of the difference in the Class 38 series VCAS since they did bid for and take account of a more complex high pressure system.

Moreover, the Alexandria prosecutors argue that Newport News never reviewed the guidance drawings at the time of the bid proposals. Therefore, they argue, Newport News is estopped in its claim from asserting that these guidance drawings were vague and ambiguous.

It is unclear, however, who was the author of the final version of the claim that included the asserted false language regarding "vague and misleading" documents. [redacted]

Consequently, the Government would have serious problems in proceeding on a false claim or false statement theory on this item (assuming there was not a statute of limitations problem) since we could not impute fraudulent intent to Newport News through an employee who was both aware of the "vague and ambiguous" language in the claim and was also aware that such language was false. N.Y. Central and H.R. Rail v. United States, 212 U.S. 481 (1909); Imperial Meat Co. v. United States, 316 F.2d 435 (10th Cir. 1963); Continental Banking Co. v. United States, 281 F.2d 137 (8th Cir. 1960).

Newport News withdrew this item from its equitable adjustment proposal by letter of September 26, 1982, stating that there were errors in the claim. Therefore, this item was not before the Navy at the time of the October 5, 1978 letters that advised the Navy that all inaccuracies had been uncovered. Given the clear withdrawal and lack of loss to the government, this item lacks prosecutive merit.

H. Nimitz Delay ($15.6 million) (Section 4.1.1 of the proposal on the Nimitz carrier) [5/]

The Nimitz aircraft carrier was an aircraft carrier of new design in that it was powered by only two nuclear power plants. It took from 1968 to 1975 to build the carrier. A factor controlling the delay was the meticulously controlled 15 month test program for acceptance of the reactors.

Snafus took place in the test program, some of which were caused by the Government and some caused by Newport New. Newport News engineers spent three months reviewing thousands of items and concluded the government was responsible for 160 days of delivery delay. The Newport News claim, however, was only for 123 days of delivery delay due to accelerated effort by the yard which reduced the amount of total delay in the delivery of the Nimitz by 37 days. Accordingly, Newport News requested compensation for 123 days delay at a cost of $125,000 per day or approximately ($15.6 million).

The Navy nuclear engineers from Admiral Rickover's department made two reviews. The first concluded that 37 of the 160 delay days identified by Newport News as Navy delay were contractor delay and only 123 delay days were Navy

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5/ This item was not raised by the Alexandria prosecution team as meriting further investigation.

delay. The second review showed a greater figure for Navy responsible delay. In either case, the Navy engineers figures are not less than Newport News' claims of 123 days of Government responsible delay.

The Richmond prosecutors had serious questions regarding the method employed by the Newport News engineers. After review, however, it was apparent to them that an expected pattern of falsification on the 100 delay events recorded could not be established. Documentary corroboration existed for more than 95 of 100 delaying events. In the two questioned events, it was concluded that resolution turned on reasonable disagreements of nuclear engineers. Each alleged item of false statement raised by the Navy was reviewed and it was concluded the Government could not prove by at least clear and convincing evidence that the allegation was false.

Since Newport News claimed less days of delay than its figures showed it was entitled to and since no pattern of falsification was found regarding individual items, this claim item established no basis for a false claim or false statement prosecution. It should also be noted that neither the Richmond or Alexandria prosecutors have suggested that the $125,000 per day figure is false.

I. Eisenhower Delay - Shipway Utilization (Section 4.1 of the proposal on the Eisenhower carrier.)[6]

Delivery of the nuclear carrier Eisenhower was delayed 731 days. In its claim, Newport News asserts that "as originally planned" when the Nimitz was launched, the Eisenhower was to replace it in Shipway 11. However, due to the problems encountered in the Nimitz construction, the Eisenhower could not replace it in the (larger) Shipway 11 and it was necessary to start construction of the Eisenhower in the (smaller) Shipway 9.

The Navy's position was that the language "as originally planned when the (Nimitz) was launched, the (Eisenhower) was to replace it in Shipway 11" - was false. The Navy assumed that Newport News was claiming that the delay in the Eisenhower was a result of moving it to the larger Shipway. The Navy analysis showed that the moving of the Eisenhower did not impact on the rate of construction. The Navy concluded that the problem was insufficient manning and not the restrictions imposed by inadequate facilities. Therefore Newport News could not claim the Navy was contractually responsible for a delay caused by inadequate facilities.

In 1977, subsequent to the filing of the claim, Newport News amended its claims documents to make clear that it was not taking the position that both ships were to be built in the same shipway. It also pointed out that it was not seeking compensation for delays in starting the Eisenhower in the smaller shipway 9 or for the cost of transferring it from Shipway 9 to Shipway 11.

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[6] The Alexandria prosecutors have not suggested this item to be further investigated.

Consequently, the Richmond prosecutors focused their investigation on whether the "originally planned" language of the claim was false. The Navy's review of the Newport News construction schedules showed no launch of the Nimitz from shipway 11 and the laying of the Eisehower keel immediately thereafter in the same shipway.

Since there is some credible evidence that the "originally planned" statement was accurate and no intent to mislead, this item cannot serve as the basis for a false claim or false statement prosecution.

J. Eisenhower Delay - Innerbottom Shielding (Section 4.1.2 of the proposal on the Eisenhower carrier) [7]

Newport News contends that a Navy change order in the type of shielding to be used in the innerbottom surrounding the nuclear reactors on the carrier Eisenhower was a primary cause of delay in the transfer of the Eisenhower from Shipway 9 to Shipway 11. The change in the type of shielding led to a holdup in innerbottom construction which in turn caused adjacent structural work to slow and virtually come to a stop late in the summer of 1971. During the slowdown, idle manpower was diverted to other projects. When the holdup was lifted in September, 1971, Newport News contends that there was insufficient manpower to make up for lost time. Consequently, transfer of the Eisenhower from Shipway 11 to Shipway 9 was delayed for 5 months.

The Navy's chief nuclear engineer labeled Newport News' position as a fabrication contending that the change in shielding had no impact on the adjacent structural work. He also pointed out that Newport News entered into contract modifications in 1971 and 1973 acknowledging that the change in shielding would not delay delivery and that by seeking money for equable adjustment, Newport News was double dipping.

568

The Richmond prosecutors spent considerable time investigating this issue.

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[7] The Alexandria prosecution team have not suggested that this item merits further investigation.

In March 1973, there was a contract modification which involved a change in the shielding. At that time, Newport News agreed that the change in shielding would not delay delivery of the ship to the Navy. Newport News contends that it was able to mitigate the effects of the 5 month delay in launch from Shipway 9 through its own efforts. The Richmond prosecutors contend that Newport News was not double dipping by asking for money in the equitable adjustment proposal for which they had previously been compensated by the change order.

Since the Richmond prosecutors investigation supported Newport News position that the change in shielding did have an impact on delay and since there was no double-dipping, this item cannot serve as the basis for a false claim or false statement prosecution.

768

K. Added Interest or Finance Charges (Claim for $107.3 million) (contained in each of the proposals)

In all of its equitable adjustment proposals, Newport News asserts that the Navy failed to make progress payments in sufficient amounts for change in work caused by the Navy where the Government did not promptly adjust the contract price. The claims contend that had the billing base been adjusted to cover the changes or had progress payments been forthcoming as contemplated by the contract, Newport News would have reduced its short term borrowing or increased its investments. Newport News claimed it was entitled to reimbursement of reasonable additional finance charges. It stated in its claim that it was not tracing ". . . specific borrowing directly to (these) contract(s) or linked any individual borrowings with any specific denied or reduced progress payment or item of increased work. . ."

Instead, Newport News described arrangements that "are normal or typical in banking" i.e. lending at the prime rate with a compensating balance (15 percent was used) as a "general practice throughout the U.S.". Newport News stated that "The actual source of capital used by the Contractor, whether it be one bank or another or Tenneco Corporation (Newport News' parent company) has little or no significance here because it is highly unlikely that the Contractor would immediately borrow an amount of money precisely equal to the amount of a reduced or denied progress payment. In addition, perfect traceability between a denied or reduced progress payment and a direct payment would be unlikely or impossible . . ."

The methodology used by Newport News was to take the cumulative costs on the contract at the end of the month and add 5% (Newport News contends that it was entitled to receive progress payments up to 105% of the actual cost incurred.) When Navy payments were subtracted, a figure "loss of revenue" was obtained to which was added the cumulative prior month's interest. This was multiplied by 115% (the 15% compensating balance was required to obtain the prime rate) and the figure then compared to the actual monthly borrowings for the entire yard.

In a review by GAO, this methodology was attacked. (1) Since Newport News was borrowing from its parent Tenneco, it should have used a rate less than prime; (2) the 15% compensating balance figure should not have been used; (3) escalation payments made by the Government should have been included in the progress payment; and (4) borrowing should have been allocated to each claim since the total borrowing for each claim greatly exceeded the average monthly yard wide figure. The Alexandria prosecutors state that the methodology used by Newport News indicates a total disregard for the Fourth. We disagree.

Newport News clearly set forth its methodology, disclaimed any tracing of specific borrowings resulting from delayed or denied progress payments; and clearly asserted that its methodology was based on general banking practice.

A false statement theory based on the October 5, 1978 letter that Newport News has informed the Navy of all inaccuracies would fail. Since Newport News' claim item was based on general practice and not actual experience and the Navy was informed of this in the claim, it would be extremely difficult to prove any inaccuracies regarding this item.

A false statement or false claim theory based on an omission of material fact would also fail since any such concealment would have to be by trick, scheme or device. There has been no evidence to date that such a trick, scheme or device for concealment of this item occurred. The only argument for the existence of this trick, scheme or device is the theory discussed and rejected in the main body of this memorandum regarding a conspiracy to defraud by overloading the claims process to obtain more money than Newport News would be otherwise entitled.

L. Navy Recruiting Claim ($23.7 million)

Newport News alleges that it encountered unanticipated costs in the performance of its contracts on the 14 vessels as a result of Navy recruiting practices. The $23.7 million figure was divided equally among the 14 ships. The claim alleges that "the contractor incurred added costs for recruiting, hiring, and training of new and replacement employees as well as added costs to adjust workload as a result of the unanticipated departure of employee who were recruited by the federal Government."

During May and June, 1974, the Government mounted an intensive recruiting campaign. Newport News alleges that the Government's promotional advertising had a direct effect upon the loss of employees to the Government at the Norfolk Naval Shipyard. During the period January 1, 1973 through October 31, 1974, Newport News had to maintain a sufficient workforce to perform on its contracts with the Navy. Newport News claims that it mounted an extensive recruitment effort to attract hourly employees, and design and salaried employees. Its detailed claim narrative, in essence, puts the blame on the Navy for the difficulty Newport News had in obtaining the desired results from its recruiting effort.

Newport News asserts that 10,493 employees voluntarily resigned from January 1, 1973 through October 31, 1974. Through the use of exit interviews, Newport News determined that 342 of the 4,722 departing employees (who gave exit interviews) were going to work for the Navy. There were, however, no specific reasons given why those employees left Newport News or why they joined the Navy. By extrapolation, Newport News calculated that a total 720 of its employees left to join the Navy.

In addition to recruiting costs incurred to maintain its work force, Newport News also claimed that it incurred training costs to maintain the level of proficiency of its employees. Newport News based its calculations in its claim on a figure of $25,000 training costs for a skilled union employee and $35,000 for a salaried or design employee. These calculations were premised upon the recruitment of employees with a zero skill level, and a five year training period. The figure also included salary costs while the new employee was doing productive work.

The matter was investigated by the Richmond prosecutors who concluded that although the claim seems outrageous, evidence indicating criminal intent was lacking.

There are several problems with the results since Ashburn failed to take into account several factors: (1) The costs for recruiting and training for the replacement of 10,493 employees is equal to 55.6% of Newport News direct and indirect labor costs for the entire 24,000 plus labor force (Newport News asserts that this is fallacious since the $25,000 and $35,000 figure should be spread over several years); (2) Many of the employees who left Newport News had limited experience and therefore the cost to replace workers with limited experience is negligible; (3) Many rehires were already skilled or worked for Newport News before and did not have to be retrained from scratch; (4) The number of departing employees included clerical and maintenance workers who do not require thousands of dollars to train; (5) The Navy loses employees to Newport News; (6) Newport News historically has lost employees to the Navy.

[redacted]

[redacted]

Any false claim or false statement theory based on this item would have to be based on a concealment of information (i.e. knowingly omitting the above cited factors from the calculation assuming arguendo that the statute of limitations has not run on the 1976 submission). However, the Richmond prosecutors did not find any witnesses who would testify that they questioned the size of this claim item. There was a failure to prove that the calculations were tampered with. A false statement prosecution requires that a concealment be done by trick, scheme or device. No evidence was uncovered by the Richmond prosecutors regarding such article, scheme or device. Moreover, there is no evidence that Newport News uncovered inaccuracies in its recruiting claims and concealed them from the Navy which would be the predicate of a false statement prosecution based on the October 5, 1978 letters.

The Alexandria prosecution contends however that the legal theory of entitlement is spurious and that the training and recruiting costs were calculated in a fashion that shows a conscious disregard for the truth. In essence, they argue that the mere assertion of the recruiting claims theory by Newport News makes it part of a conspiracy to defraud the United States by overloading the claims process in order to obtain a greater settlement than they would otherwise be entitled.

This argument falls on two grounds in the instant case. First, there is no evidence that anyone in Newport News above Ashburn's level told him how to make the calculations or tampered with his figures. Therefore, there is no link between any of the conspirators (assuming arguendo that a conspiracy existed with Willis and his superiors) and this particular claim item. Second, (as set forth in the main body of this memorandum) in a conspiracy to defraud prosecution, the courts almost uniformly require some evidence of deception or deceit. None exists with regard to the Navy recruiting claim part of the overall claim.

M. Fictitious Manhours - Deterioration of Labor (claim for $78 million with respect to 5 Class 688 submarines) [8]

As part of Newport News assertion that the Navy was responsible for delays in ship construction, Newport News claimed that its workers became less efficient with every revision in delivery schedules of the ships. According to Newport News, 15 minutes of every productive hour was wasted in the month following a schedule change; 13 minutes in the second month; 9.5 minutes in the third month.

The Richmond prosecutors investigated this item to determine whether the figures on deterioration of labor were overstated, tampered with to meet pre-arranged target values and whether any good-faith justification could be made for the calculation.

[redacted]

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[8] This claim item was not suggested for further investigation by the Alexandria prosecution team.

The Richmond prosecutors were also unable to prove that the calculations were tampered with or that any misrepresentations were made to the Navy. Therefore, this item alone cannot be the basis for a false claim or false statement prosecution based on existing case law under 18 U.S.C. 287 and 1001. In addition, the statute of limitations has run on the March, 1976 Maxi-Claim submission. Moreover, since there is no evidence of Newport News uncovering inaccuracies and concealing them from the Navy on this item, there can be no false statement based on the October 5, 1978 letters submitted to the Navy.

It has been suggested, however, that the mere assertion of an outrageous theory of entitlement without the support of any empirical studies is fraudulent even though the Government is accurately told how the calculations were reached and that they were mere estimates. Under this view, the mere assertion of the deterioration of labor theory by Newport News makes it part of a conspiracy to defraud the United States by overloading the claims process in order to obtain a greater settlement than they would be otherwise entitled.

This argument falls on two grounds in the instant case. First, there is no evidence that anyone in Newport News above Seifert's level told him how to make the calculations or tampered with his figures. Therefore, there is no link between any of the conspirators (assuming *arguendo* that a conspiracy existed with Willis and his superiors) and this particular item. Secondly, (as set forth in the body of the main memorandum) in a conspiracy to defraud prosecution, the courts almost uniformly require some evidence of deception or deceit. None exists with regard to the deterioration labor part of the overall claim.

N. OSHA and EPA Claims (Sections 5.9.2. and 5.9.3. of proposal on the Class 38 series cruisers)

Newport News alleges in Claim item 5.9.2 on the DLGN 38-40 cruiser contract that it incurred increased costs due to government actions, specifically, the passage of environmental legislation including the Clean Air Act of December 1970 and the Water Pollution Control Act Amendments of October 1972. Claim item 5.9.3 on the cruiser contract alleges that Newport News incurred additional costs due to the government's passage of the Occupational Safety and Health Act of 1970.

Newport News alleges that since the contract negotiations were based upon its September 15, 1970 bid proposal, no consideration was given to the impact of the subsequent Clean Air Act or Water Pollution Control Act Amendments. Newport News also alleges that since OSHA was not established until April 1971, no consideration was given to the impact of OSHA on the proposed contract.

Claim item 5.9.2 (Added Environmental Control Requirements) states, in pertinent part:

> In December of 1970, the Environmental Protection Agency was established and under the authority of the amendments, the emission standards were subsequently promulgated. The federal water pollution control act amendment was enacted during 1972 (October). During this same period, actions were under way which would lead to definitization of the contract. Since the negotiation in progress was of the 1970 proposal, no consideration was given by either contracting party to the impact of the Clean Air or Water Pollution Control Act Amendments upon the proposed contract. (Emphasis Added)

Claim item 5.9.3. (Occupational, Safety and Health Act of 1970) states, in pertinent part:

> During the same period [December 1969 - December 1971], the Government enacted the Occupational Safety and Health Act (OSHA) in April of 1971. Since the negotiation in process was of the contractor's 1970 proposal, no consideration was given by either contracting party to the impact of OSHA upon the proposed contract. In this section of the proposal, the contractor will show that OSHA did have an effect upon the performance of this contract, what that effect was, and that the Government, in the contract, had agreed in such cases to an equitable adjustment.

The claims then set out Newport News argument as to why these added costs should be passed on to the government, including the steps the Yard took in order to comply with the new legislation.

The original bid proposal was submitted by Newport News in response to the request for proposal and guidance plans which were sent to Newport News November 1969. The original Newport News bid proposal was submitted on September 15, 1970. However, on July 23, 1971, a supplemental proposal was submitted by the Yard. In its July 1971 bid proposal, the Yard attributed a direct cost of $3,700,608 plus 2.4 percent of overhead (amounting to $2,556,000) for compliance with OSHA and EPA requirements. Schedule E, attached to the July 1971 bid proposal, reads as follows:

> The proposed target costs for these ships includes $1,870,591 for the DLGN 38, $987,675 for DLGN 39, and $932,338 for the DLGN 40 to cover the estimated impact of current laws such as the Occupational Safety and Health Act of 1970 and Environmental Control legislation on direct costs and associated overhead. Estimated costs

> were derived by applying a 2 percent factor to all productive (including supervision) hours plus associated overhead to reflect the loss of efficiency, expected due to the necessity of operating under the adverse constraints. Also included for each ship is an estimated $50,000 for miscellaneous consumable materials.
>
> The proposed overhead rate includes 2.4 percent to cover additional and direct costs estimated to be incurred as a result of the legislation. The additional overhead was derived by evaluation of the capital expenditures required, cost of indirect labor, lost direct labor hours for various medical examinations, record keeping and other miscellaneous costs.

A Navy negotiator has stated that a comparison of the Navy's negotiated objective to the Newport News bid discloses that the amount requested in the bid for the OSHA and EPA items had been excluded from the contract. Therefore, Newport News had not been paid for the additional costs associated with the EPA and OSHA acts.

The Alexandria prosecution team did not investigate this item. From the above facts, however, they state that "it is crystal clear that contrary to the representations made in claim items 5.9.2 and 5.9.3 consideration was given to possible increased costs due to EPA and OSHA requirements."

There is a serious question whether Newport News made an affirmative representation which could serve as the basis for a false claim or false statement prosecution (assuming arguendo that there is no statute of limitations problem with regard to the 1976 Maxi-Claim).

There were two proposals. The original September 15, 1970 proposal and the July 23, 1971, supplemental proposal. The 1971 proposal, but not the 1970 proposal, contains reference to additional costs due to OSHA and EPA items. Therefore, Newport News could argue that it was literally correct in its claim that "no consideration was given" (to the OSHA and EPA items) during the negotiation of the "1970 proposal". However, the period of time referred to by Newport News, December 1969 - December 1971, which would, of course, cover both proposals, adds ambiguity to what was in fact meant.

There has been no investigation focusing on who prepared the claim, whether he reviewed the 1970 and 1971 proposal language, or whether he was instructed to write the proposal in spite of his knowledge of the true facts. Therefore, we presently have no evidence of fraudulent intent. At best, the proof would only establish that Newport News had failed to tell the Navy in 1976 something which the Navy knew since 1971 - that consideration had been given to the OSHA and EPA items in the 1971 proposal and had been rejected by the Navy at that time.

The Alexandria prosecutors also argue that the OSHA and EPA items lack a "colorable legal basis" since a contractor cannot be held liable directly or indirectly for public acts of the United States as a sovereign. Therefore, the filing of this item is another "indicium of (Newport News) lack of good faith".

This argument is similar to others, like the Navy Recruiting claim, where it could be argued that Newport News was submitting this item in an attempt to overload the claim process to get more money that it would otherwise be entitled. This conspiracy to defraud theory is without judicial support as discussed in the main body of the memorandum.

EXHIBIT DD

MAY 18, 1983 -- CRITIQUE OF THE OGREN MEMO

Memorandum

Subject
Critique of the Fraud Section Memo
on the Newport News Shipbuilding
Investigation

Date
May 18, 1983

To
D. Lowell Jensen
Assistant Attorney General
Criminal Division

From
Elsie L. Munsell
United States Attorney
Eastern District of
Virginia

Joseph J. Aronica
Chief, Criminal Division
U.S. Attorney's Office

Joseph A. Fisher, III
Chief, Civil Division
U.S. Attorney's Office

David B. Smith
Deputy Director
Asset Forfeiture Office
Criminal Division

I. INTRODUCTION

In January 1982, by agreement, the Alexandria prosecution team relinquished this investigation to the Fraud Section of the Criminal Division for handling. Two months prior to that, we wrote a thorough 110 page Status Report that summarized some of the more significant results of our investigation up to that point, and also analyzed a number of possible legal defenses raised by Newport News Shipbuilding (hereafter NNS). In that Status Report, we recommended that the investigation continue. We did not recommend that the company or any of its employees be indicted at that time because we felt that work remained to be done to fully develop a case. We made it clear, however, that we believed a prosecutable case could be developed if the necessary resources were made available.

The Status Report demonstrated that NNS had in fact conspired to defraud the government on a massive scale. The Status Report further concluded that there was no legal impediment to a successful prosecution. In our view, the Status Report made a very compelling argument for continuing the investigation.

We still are convinced that there is a prosecutable case against the company and that an indictment with a reasonably good chance of success could be put together before October 5, 1983. 1/ A two count indictment charging the company with conspiracy to defraud the United States by obtaining payment on any false, fictitious or fraudulent claim, in violation of 18 U.S.C. 286 and conspiracy to defraud the United States by impeding and impairing its lawful functions under 18 U.S.C. 371 could be quickly drafted. 1a/ It is not clear whether such an indictment would be multiplicitous. Assuming it was, there would still be no error in allowing both counts to go to the jury.

1/ As our Status Report explains (pp. 105-106), there are various theories available that would allow us to argue that the conspiracy continued long after October 5, 1978, when NNS and the Navy agreed to a lump sum settlement of the company's claims. Thus, it is far from clear that the statute of limitations will run out on October 5, 1983. Nonetheless, the fact that an indictment returned after October 5, 1983 might be held to be time-barred is an argument against devoting further substantial resources to the investigation at this point.

The statute of limitations question should be examined very carefully before any decision is made to decline prosecution.

It is absolutely clear that the statute of limitations will not run on a false claims conspiracy (18 U.S.C. 286) or conspiracy to defraud the United States (18 U.S.C. 371) until at least October 5, 1978.

1a/ It is no longer advisable to bring substantive false claim counts under Section 287 because the Statute of Limitations probably ran out on such offenses on August 1, 1982. See Status Report at 102, 108.

E.g., United States v. Colson, 662 F.2d 1389, 1392 (11th Cir. 1981). We would rely upon the evidence of an overall conspiracy plus individual claim items that can be shown to be either false or based on legally outrageous theories of entitlement or both. 2/ Some of the claim items based upon outrageous theories of entitlement would have great jury appeal because the company's bad faith is so readily apparent and the issues are not technical. These claim items also have the advantage of being for huge sums of money, unlike some of the hard claim items we can prove to be false. In this category we would include the following claim items: Deterioration of Labor/Parkinson's Law ($97 million); Navy Recruiting ($24 million); Added Financing Costs ($107 million); OSHA/EPA Regulations ($5.5 million); and Deferred Work ($51.5 million). 3/ We would be happy to draft such an indictment to aid you in your decision.

II. THE FRAUD SECTION MEMO IS NOT AN ADEQUATE EVALUATION OF THE STRENGTHS AND WEAKNESSES OF THE NEWPORT NEWS CASE

The Fraud Section memo marshals only the arguments -- both good and bad -- against prosecution. Some of these arguments are identical to those contained in the company's "Confidential Memorandum." The memo's characterization of the evidence and the potential legal defenses available to the company cannot withstand serious scrutiny.

2/ We would not rely solely upon claim items based on legally outrageous theories of entitlement to compensation. Thus, there would be no need for the court to confront the interesting question of whether a conspiracy to defraud the United States could be predicated entirely upon such claims. The claim items based on outrageous theories of entitlement would be one among many facts set forth in the "methods and means" parts of both conspiracy counts.

3/ The OSHA/EPA claim item can also be shown to contain a false statement.

It would serve no purpose here to rehash the extremely complex evidence summarized in our Status Report and in Edward C. Weiner's various memoranda. 4/ Nor can we respond to every point made by the Fraud Section memo in the two-week time period alloted for this critique. 5/ What we can do here is attempt to show that the major factual and legal premises of the Fraud Section memo are incorrect. We can also highlight some of the most questionable aspects of the memo.

The memo's conclusions are summarized at page 2. 6/ The recommendation that the Department decline prosecution and that no further investigation be conducted is based on three conclusions, each of which is incorrect: 1) that only four of the 264 individual claim items contain false claims or false statements; 2) that there are "adequate legal defenses

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4/ It is important to note that Mr. Weiner's August 5, 1982 memo discussed a number of potentially prosecutable claim items that were not discussed in the Alexandria team's Status Report. Mr. Weiner's memo also developed some additional evidence of an overall conspiracy to defraud that was not contained in the Status Report.

Mr. Weiner's memorandum of November 17, 1982 presented additional important evidence, some of which we summarize infra.

5/ We would be happy to provide you with a follow-up memo addressing any points on which you want further analysis. It should not be assumed that we accept the correctness of any point in the Fraud Section memo simply because we do not address it here. We refer you to our lengthy Status Report for a detailed discussion of the evidence developed up to that point.

6/ The memo implies that its recommendations are unanimous. But, as Mr. Ogren stated at the meeting on May 2, 1983, Edward C. Weiner wrote a dissenting memo.

which will make it virtually impossible to prosecute those [four] items on a false claims or false statement theory"; and 3) that the use of an overall conspiracy to defraud theory would be "impossible under existing law and *** largely inconsistent with the evidence developed during the six years of the investigation."

Whether or not you decide to decline prosecution of this case, it is important to set the historical record straight. In view of the fact that the Department is presently in the process of evaluating its handling of the entire group of fraud cases referred to us by the Navy many years ago, and in view of the fact that more than one Senator is currently looking into this area, we believe that even if you decide to decline prosecution at this point, it would be a serious mistake to adopt Mr. Ogren's memo as the Criminal Division's explanation of why prosecution was declined. [7]

III. THE EVIDENCE OF FRAUD

We assumed that the evidence set forth in our Status Report and its appendix would have convinced anyone that a massive conspiracy to defraud the government did exist at NNS, leaving aside the question whether or not it could be successfully prosecuted. 8/ The Fraud Section's memo gives the impression that there was probably no conspiracy and little if any actual fraud. We submit the evidence is far to the contrary. 9/ The fact is that no one outside the Navy is familiar with more than a small fraction of the 264 claim items. 10/ A substantial number of the claim items that have received even the briefest attention from Department prosecutors have been shown to be either false, apparently false, and/or based upon legally outrageous theories of entitlement. The Fraud Section's memo makes it appear that the nine claim items discussed in our Status Report were the only items we believed had prosecutive potential. However, our Status Report made it clear that was not the case. We stated (Status

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[7] Assuming that the Fraud Section's position is accepted by you, we would recommend that, in the future, there be better coordination between the ultimate decision makers and the line prosecutors. Had the Fraud Section's views been communicated to the prosecutors handling the investigation they could have pursued the evidence it deems essential to a successful prosecution.

8/ Deputy Assistant Attorney General Mark Richard read our entire Status Report and commented that the evidence of fraud detailed therein made this case appear stronger than the Litton case, which the Department indicted many years ago, when Mr. Richards was Chief of the Fraud Section. Mr. Richard's comment was made without the benefit of the additional evidence of fraud detailed in the various memoranda later written by Mr. Weiner. We are also familiar with the evidence of fraud in the Litton case since it was indicted in our district and Joseph A.Fisher, III has been assigned to that case from the beginning. We agree with Mr. Richard's evaluation of the relative strength of the two cases. The most salient difference between the two cases is that the Litton prosecution is based on a single false claim whereas in this case we have many false claim items which collectively belie any innocent explanation of the company's behavior.

9/ Indeed, the obvious fact that the company settled for $208 million on a claim of $894 million indicates that the great majority of claim items had no substance.

10/ The Navy experts have expressed the view that the vast majority of the claim items are either false or based upon frivolous theories of legal entitlement. See our Status Report at 106 n.55 ("the Navy CITARS indicate that some degree of fraud was involved in the majority of the 260-odd claim items.")

Report p. 4 n.5):

> The present team's investigation has thus far focused almost entirely on the DLGN 38-40 cruiser contract claims for practical reasons that have nothing to do with the relative merits of NNS's cost overrun claims on the various ship contracts. Thus, we have no reason to believe that the claims on the aircraft carriers and submarines have more integrity than the cruiser claims.

The company's 264-item claim was like a huge field of oil lying just beneath the surface of the earth. Wherever prosecutors probed, oil (evidence of fraud) bubbled to the surface. Mr. Weiner's probing did not even involve a grand jury investigation or interviewing witnesses. Merely by reading the claim items, CITARS and certain company documents already in our possession, he was able to identify several additional claim items as fraudulent. 11/

But the real evidence of the company's fraud is contained in the documents and fraud convictions have been won on the basis of documentary evidence alone, even in the face of self-serving statements by company employees. 12/

11/ Mr. Weiner spent several months in the basement of the U.S. Attorney's Office in Alexandria reading documentary evidence and thoroughly acquainting himself with the facts of the case.

12/ We would rely heavily upon the Navy experts who took apart the company's claim to explain the significance of the documents to the jury.

A jury could readily infer a conspiracy to defraud the government from the massive evidence of fraud contained in the claim, even without the direct evidence of a conspiracy.

)The Fraud Section's memo examines each item of fraud and each item of evidence in isolation. It eschews any consideration of the evidence as a whole. While this is the kind of argument the company might make to a jury at trial, it has no place here.

It is worth mentioning some of the more significant evidence Mr. Weiner developed by taking the time to read a few of the hundreds of thousands of company and Navy documents in our possession. (It should be emphasized that only a tiny fraction of the documents have been read by any Department prosecutor or investigator.) 14/

13/ A key witness on the overall conspiracy and the company's motives is David Leighton, a brilliant engineer who was Admiral Rickover's principal aide and the architect of the contracts with Newport News. He would explain the series of poor management decisions made by NNS in the early 1970s that put the company deep in the red. He can testify that the company had a target figure of $200 million in cost adjustment claims and that the company made a deliberate decision to inflate its claims sufficiently to reach that target settlement figure.

14/ The Fraud Section memo creates the impression that this case has been thoroughly investigated. That is not quite accurate. In fact, the Richmond prosecution team actively investigated the case for only about one year and its efforts were far from effective. The Alexandria prosecutors spent only three months actively investigating the case. That time was devoted largely to proving the falsity of a single hard claim item, the VCAS.

Joseph A. Fisher, III details some of the mistakes and false starts that have plagued the government in his chronology of the investigation, which is being submitted separately.

Mr. Silverstein had instructed Mr. Weiner to carefully examine two claim items (Discharge Sea Chests and Reactor Shielding)

Mr. Silverstein was of the view that additional evidence of false statements regarding "hard" claim items was needed to make a prosecutable case -- a view we were in accord with.

The Fraud Section memo states, at p. 12, that the "principal problem" with a conspiracy to file false claims theory is that "it is not possible to prove any substantial portion of the various claims to be false." (The four claim items recognized as false add up to only $7 million or approximately 3%

of the settlement total of $208 million.) In the first place, we reject the premise that only those four claim items can be shown to be false.

The Fraud Section memo argues (pp. 13, 27-29) that, even with respect to the four claim items it recognizes as false, there is no evidence of specific intent

These arguments completely misperceive the law on specific intent and the criminal liability of corporations for the acts of their employees. Moreover, the factual conclusions drawn from the evidence in this part of the memo are extremely dubious.

The leading Fourth Circuit cases on the intent element of a Section 287 offense are United States v. Maher, 582 F.2d 842 (1978), cert. denied, 439 U.S. 1115 (1979), and United States v. Blecker, 657 F.2d 629 (1981). Under established principles of conspiracy law (United States v. Feola, 420 U.S. 671 (1975)), the same intent requirement would probably be applicable to a conspiracy charge under Section 286 although Section 286 focuses upon obtaining payment for, rather than filing the false claim.

Noting that Section 287 is phrased in the disjunctive, the Fourth Circuit held in Maher and Blecker that a conviction under Section 287 may be obtained based on proof that a claim submitted to the government is either false, fictitious or fraudulent. See also United States v. Milton, 602 F.2d 231 (9th Cir. 1979). In Maher, the court held that, in each instance, the defendant must act with knowledge that the claim was false, fictitious or fraudulent and with a consciousness that he was doing something which was either "morally wrong" or which violated the law. 582 F.2d at 847. Since the knowing submission of a false, fictitious or fraudulent claim is morally wrong, it is not apparent what if anything is added by the requirement that the defendant act with a consciousness that he was doing something morally wrong. Indeed, in Blecker, the Fourth Circuit made no mention of this supposed requirement. 17/ 657 F.2d at 634. Thus, it does not appear that the intent element of the offense requires anything more than a showing of knowledge that the claim was false,

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17/ Other courts of appeals have held that specific intent is not an element of a Section 287 offense (United States v. Irwin, 654 F.2d 671, 681-682 (10th Cir. 1981), cert. denied, 455 U.S. 1016 (1982)), or that it is not an element where the government attempts to prove that the claim is false or fictitious as opposed to fraudulent (United States v. Milton, 602 F.2d 231 (9th Cir. 1979)).

fictitious or fraudulent, as stated in Blecker. In any event, the Maher requirement that the government show that the defendant acted with a consciousness that he was doing something morally wrong adds nothing material to the government's burden of proof. Thus, the Fraud Section memo's attempt to set up "specific intent" as an insuperable evidentiary barrier to prosecution is sheer nonsense. However the intent element is formulated, it is not necessary to produce a confession of company officials to satisfy that element. Maher itself approved an instruction that specific intent

> may be determined from all the facts and circumstances surrounding the case. And intent ordinarily may not be proved directly, because there is no way of fathoming or scrutinizing the operations of the human mind, but you may infer the defendant's intent from the surrounding circumstances.

582 F.2d at 846. This is hornbook law. E.g., United States v. Adler, 623 F.2d 1287, 1289 (8th Cir. 1980); United States v. Rifen, 577 F.2d 1111, 1113 (8th Cir. 1978).

The Fraud Section memo (at p. 27) also cites Maher for the proposition that "proof of reckless indifference or disregard as to the truth or falsity of a statement is not enough." But Maher approved a jury instruction to precisely the opposite effect. See 582 F.2d at 846. 18/

18/ The jury instruction stated that the contractor had no right to make a claim for payment "for work that he knew had not been done or put on such a voucher a claim for payment with reckless indifference as to whether the work had been done or not, that is, whether the claim was true or false." Ibid. (Emphasis supplied.)

At least one other court has also approved a recklessness instruction in a Section 287 case. United States v. Precision Medical Laboratories, Inc., 593 F.2d 434, 443-444 (2d Cir. 1978). To summarize, we have shown that all the government would need to prove in support of Section 287 counts is that Newport News employees submitted claims that were false or fraudulent, with reckless indifference as to whether they were true or false. Of course, the knowledge or recklessness element may be inferred from all of the surrounding evidence, as it almost always is.

The memo follows its discussion of specific intent with a number of factual statements and inferences from the evidence with which we disagree. We will comment on each of these statements and inferences in turn.

1. "The overall process of decentralizing the claims writing among 200 plus contract specialists and the reassembling of the claims suggests proper controls were present."

Our comment: Clearly, in view of the fact that the claim was extremely complex and longer than the Encyclopedia Britannica, one or two persons could not write it. Thus, the decentralization of the claims writing process was a necessity. It suggests nothing one way or the other about the integrity of the process.

2. "The review process

suggests a weeding out of dubious claims.

It also provides in several clear instances an advice of counsel defense. In fact, the entire process suggests on the surface that Newport News was trying to submit only valid claims."

Our comment: Internal control and review, we submit, is a neutral factor, available for use to good or evil ends.

It is also a fact that the company's soft claim items, which constitute the bulk of the $894 million claim, are largely based on outrageous theories of entitlement [redacted] Our careful dissection [redacted] for the VCAS item revealed a sophisticated effort "to combine fabricated facts with legal theory in such a way that the end product -- the final version of the claim -- would appear to be valid on its face." Status Report at 46-47. The VCAS evidence detailed in our Status Report also clearly reveals that proper internal controls were absent from the claims process.If the review process did in fact eliminate [redacted] items, all that suggests is the sophistication of the conspiracy. [redacted]

[redacted]

3. "Second, the motivation to submit accurate claims is readily apparent. Newport News employees had the perception that Admiral Rickover intended to accuse Newport News of fraud."

Our comment: It is hardly determinative to speculate that this company or any of the other shipyards was deterred from submitting false claims by the fear that Admiral Rickover would accuse them of fraud. The company's motivation to submit false claims is readily apparent from analysis of its financial problems in the relevant time period.

. The evidence, tending to show good faith throughout the claims process, negates specific intent to defraud."

Our comment: This statement is unsupportable

5. "Third, in a limited prosecution of two or three claim items, the Government would be in the anomalous position of arguing that intent to defraud is present although the extent of the fraud we could establish would at most be two or three fraudulent items out of 264...."

Our comment: Although the memo states on p. 2 that four claim items "appear to contain false claims or false statements," it argues here that "the extent of the fraud we could establish would at most be two or three fraudulent items." What happened to the four false items on p. 2? Of course, we believe that we could demonstrate that many more items are false or based on legally outrageous theories of entitlement.

Mr. Ogren also finds "little evidence to support the alternative prosecution theory" that the company conspired to defraud the United States by submitting a massive number of claims it knew to be meritless in an effort to overload the Navy claims adjustment process. 19/ In view of the large number of frivolous claims on soft items, we do not understand how Mr. Ogren can claim there is little evidence to support this conspiracy theory.

19/ It is perhaps more likely that the company submitted the meritless claim items in the expectation that the Navy would settle the whole claim on a percentage basis than that the company actually expected to overwhelm the Navy's claims adjustment process.

We are obviously capable of identifying a plethora of claim items as non-meritorious;

Mr. Ogren states (p. 17) that there is "no authority for predicating a conspiracy to defraud the United States by impeding and impairing its lawful functions on conduct that does not include a component of deception or trickery." Even if that were the law -- and we do not concede that it is -- it hardly would stand in the way of a successful prosecution under Section 371 in this case, where there is abundant evidence of "deceit, craft, trickery, or at least means that are dishonest." Hammerschmidt v. United States, 265 U.S. 182, 188 (1924). 21/ The statement

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21/ The Hammerschmidt opinion adds, immediately after the words quoted by Mr. Ogren, that "[i]t is not necessary that the Government shall be subjected to property or pecuniary loss by the fraud, but only that its legitimate official action shall be defeated by misrepresentation, chicane or the overreaching of those charged with carrying out the government intention." Ibid.; emphasis supplied.

There is nothing novel about the Section 371 count we propose. It was successfully used in the Norfolk Ship prosecution in our district in 1974.

(p. 17) that Hammerschmidt is "the case most closely resembling this one" is simply wrong. The memo's own summary of the facts in Hammerschmidt shows that it was a prosecution against individuals who were urging non-compliance with military registration laws by circulating handbills. There was concededly nothing deceitful or dishonest about this First Amendment activity.

In any event, it is doubtful that the Hammerschmidt requirement of deceit, craft, trickery or dishonesty has survived later cases. In United States v. Shoup, 608 F.2d 950, 963-964 (3d Cir. 1979), a case cited by the memo, the court of appeals stated that the Hammerschmidt language "has long ago been discarded by the courts. Section 371 now reaches 'any conspiracy for the purpose of impairing, obstructing, or defeating the lawful function of any department of government.' Dennis v. United States, 384 U.S. 855, 861 (1966)." Thus, contrary to the memo, Shoup is not a case where the court "found a conspiracy to defraud without stating the express requirement that there be proof of trickery/ deception." Rather, the Shoup decision clearly rejected the Hammerschmidt language that the memo asserts (p. 18) "presents an insurmountable *** problem." 22/

22/ The Shoup decision is also significant insofar as it involved a factual situation somewhat analogous to that posited by Mr. Ogren -- the filing of a report that contains no misrepresentations or concealments but is deliberately misleading. The Third Circuit held that "[a]lthough Shoup may have submitted a technically accurate report, the jury nonetheless reasonably could have concluded that he intended to defraud the United States." 608 F.2d at 950. So too here, even if the company's claim did not contain a single falsehood or concealment, it was still designed to obtain some payment on claim items that the company knew had no legal merit. Such behavior is plainly "dishonest" even within the meaning of Hammerschmidt. See also United States v. Johnson, 337 F.2d 180, 184-185 (4th Cir. 1964).

IV. POTENTIAL DEFENSES AVAILABLE TO THE COMPANY

In addition to the legal issues we have already disposed of, the memo sets up various defenses as obstacles to a successful prosecution of the company. Here, we will briefly show that none of these "defenses" poses a problem.

A. The Admiral Rickover Defense

Admiral Rickover is one of the most widely admired Americans of our time. Three former presidents from both parties attended a recent dinner in his honor. His commitment to integrity in the procurement process is widely known. We can readily argue that, in this case, he had reason to be vigilant with respect to the company's claims. A jury would love it.

B. Preindictment Delay

The memo suggests (pp. 29-30) that if an indictment is returned it might be dismissed by the district court on grounds of preindictment delay. 23/

there is no legal basis for a motion to dismiss based on preindictment delay. Delay attributable to lack of diligence or even negligence on the part of the government does not provide a basis for a due process/preindictment delay claim. Intentional misconduct or reckless disregard for the defendant's interests must be shown. There is no evidence that the government intentionally delayed this investigation for the purpose of prejudicing the company's rights. Moreover, there is no evidence

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23/ We have excluded from this memo discussion of the management of this investigation. That topic is a proper subject for inquiry in an effort to learn how to better manage similar investigations in the future.

that the company has been prejudiced by the delay. Both prejudice and intentional misconduct must be shown to support a preindictment delay claim. United States v. Lovasco, 431 U.S. 783 (1977); United States v. Marion, 404 U.S. 307, 324-325 (1971).

C. The Settlement Figure ($208 Million) Is Regarded By The Navy As Fair

The memo states (p. 31) that "the final sum paid as an equitable adjustment ($208 million) is regarded as fair by relevant Navy officials." We would like to know who these anonymous Navy officials are. Certainly, the Navy officials we have talked to do not regard it as fair. In any event, whether or not the $208 million settlement was fair is, of course, legally irrelevant. E.g., United States v. Pintar, 630 F.2d 1270, 1277-1278 (8th Cir. 1980); United States v. Anderson, 579 F.2d 455 (8th Cir.), cert. denied, 439 U.S. 980 (1978). This is especially true where a known consideration for settlement by the Navy was "litigative risk."

D. The Company's Criminal Liability For The Acts Of Its Employees

Throughout the memo and its appendix, it is asserted that 1) there is no link between any of the alleged high level conspirators and particular claim items that have been shown to be false or based upon legally outrageous theories of entitlement; and 2) the absence of such an evidentiary link is somehow fatal to this prosecution. We submit this is wrong for a number of reasons. In the first place, the claims writers were themselves conspirators. The conspiracy was not limited to [redacted] and a few high level officials of the company. Second, the higher-level officials were at least aware of the fact that the soft claim items were basedon outrageous theories of entitlement. Thus, they cannot avoid responsibility for those items. Third, the circumstantial evidence allows one to infer that at least some of the higher-ups were also aware of the falsity of many of the hard claim items and either condoned or encouraged such falsity. Fourth, and most important, the memo's apparent assumption that the company cannot be held criminally liable for the actions of the lower level claims writers unless there is evidence that higher level officials were also involved in generating false claims is simply incorrect. See, *e.g.*, *Paul F. Newton & Co. v. Texas Commerce*, 630 F.2d 1111, 1121 (5th Cir. 1980); *United States v. Beusch*, 596 F.2d 871, 877-878 (9th Cir. 1979); *Apex Oil Co. v. United States*, 530 F.2d 1291, 1295 (8th Cir. 1976); *United States v. Dye Construction Co.*, 510 F.2d 751 (10th Cir. 1975); *Steere Tank Lines, Inc. v. United States*, 330 F.2d 719 (5th Cir. 1963); *Continental Baking Co. v. United States*, 281 F.2d 127, 149-150 (6th Cir. 1960); *United States v. Milton Marks Corp.*, 240 F.2d 838 (3d Cir. 1957); *United States v. Steiner Plastics Mfg. Co.*, 231 F.2d 149 (2d Cir. 1956). As already noted, a corporation may not escape criminal liability for the acts of its employees even if those acts are in contravention of repeatedly stated corporate policy.

> "The employer 'does not rid himself of [the duty to eliminate illegal practices] because the extent of his business may preclude his personal supervision, and compel reliance on subordinates. *He must then stand or fall with those whom he selects to act for him. He is in the same plight, if they are delinquent, as if he had failed to abate a nuisance on his land.*"

Continental Baking Co. v. United States, *supra*, 281 F.2d at 150, quoting United States v. Armour, 168 F.2d 342, 343-344 (3d Cir. 1948) (emphasis in original). 25/

The memo asserts (p. 19) that "in the unique context of a corporation committing the offense of false statement, the Government has the obligation to prove that knowledge of the falsity was centralized in one officer or employee." It is not apparent what "centralized" means here. The memo seems to be suggesting that it must be shown that an identifiable employee had knowledge of the falsity of each claim item; in other words, it would not be enough for the government to prove that whoever wrote a particular claim item must have known it was false. Accordingly, unless the government could identify the particular individuals involved, the company would escape liability. (See memo at 23.) But we know of no case law so holding and we would be surprised if a court held that a company can defend itself by refusing to identify the individuals responsible for particular claim items. In any event, we do know who was responsible for the preparation of all the company's claims on the nuclear carriers and cruisers

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25/ In the appendix to his memo, Mr. Ogren states (App. 21) that "we could not impute fraudulent intent to Newport News through an employee who was both aware of the 'vague and ambiguous' language in the [VCAS] claim and was also aware that such language was false." This makes no sense. The three cases cited for that proposition hold precisely the opposite.

E. Materiality

One claim item that the memo concedes (p. 24) "holds some potential for being proven to be fraudulent" involves the reactor plant hot discharge sea chests on the cruisers. 26/ However, the memo states (*ibid*.) that, "[n]otwithstanding the apparent inaccuracy of the Discharge Sea Chest claim, there are technical problems which would preclude a prosecution predicated on this item even assuming otherwise sufficient evidence were developed in further grand jury proceedings." These "technical problems" are two in number. First, the fact that the Navy had already reviewed and rejected the company's 1974 request for a contract adjustment to cover additional costs it claimed had been incurred in building the discharge sea chests "could arguably preclude that item from being 'material' to the Government in a false claim prosecution." Elsewhere (pp. 18-19), the memo also implies that this materiality requirement would somehow present a problem for us. However, it is well settled that the test for materiality is merely "whether the false statement has a natural tendency to influence, or was capable of influencing, the decision of the tribunal in making a determination required to be made." *United States v. Snider*, 502 F.2d 645, 652 (4th Cir. 1974), quoting *Weinstock v. United States*, 231 F.2d 699, 701-702 (D.C. Cir. 1956). The cases make it clear that a statement may be material even though the government does not actually rely on it. "It is enough that 'the potential for subversion of an

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26/ In our opinion, we and Mr. Weiner have already proven conclusively that this item is fraudulent.

agency's functioning [can] readily be inferred.'" *United States v. McIntosh*, 655 F.2d 80, 83 (5th Cir. 1981), quoting *United States v. Beer*, 518 F.2d 168, 172 (5th Cir. 1975). "A statement can be material even if it is ignored or never read by the agency receiving the misstatement [citation omitted.] 'False statements must simply have the capacity to impair or pervert the functioning of a governmental agency.'" *United States v. Diaz*, 690 F.2d 1352, 1358 (11th Cir. 1982), quoting *United States v. Lichenstein*, 610 F.2d 1272, 1278 (5th Cir.), *cert. denied*, 447 U.S. 907 (1980). See also *United States v. Cowden*, 677 F.2d 417, 419 (8th Cir. 1982).

In light of this case law, it is not possible to argue that the false statements contained in the Discharge Sea Chest claim item were immaterial. The false statements were clearly capable of influencing the Navy. The fact that the Navy rejected a similar claim two years earlier might have been overlooked. If NNS thought the claim item could not influence the Navy it obviously would not have submitted it.

The second "technical problem" Mr. Ogren perceives (p. 25) in the Discharge Sea Chest claim item (and also in the VCAS claim item) is that the company "could also argue with some merit that the contract specifications were ambiguous and susceptible to the interpretations embodied in its claims." This is clearly wrong. The specifications for both items were more than adequate.

V. POLICY CONSIDERATIONS

We recognize that the decision whether to proceed or to close this investigation at this time is a difficult one, on which reasonable lawyers can differ. In order to reduce the litigative risk raised by the statute of limitations question, there would have to be a substantial, full-time investment of prosecutorial resources in the face of conflicting demands for those resources. For those unfamiliar with the case materials, there would necessarily be lead - learning time involved. It is also reasonable to expect that the case brought could not be given the polish in preparation desired by dedicated prosecutors, which fact increases trial risk. On the other hand, there are significant policy considerations that urge one last try. Declination, on these facts, would tend to confirm the speculation that sophisticated conspiracies can escape criminal sanctions. This is particularly of concern, where, as here, the contractor has advanced large, frivolous claims and has sought insulation

We should also keep in mind that the damage to the United States involves not just the final payment, but the time and expense needed to evaluate and deal with frivolous claims, to the detriment of ongoing agency tasks. There is a real need to deter such conduct in the future. Notwithstanding delays and digressions, the United States has invested much time and effort in this investigation. A further short investment, which, we believe, could reasonably be expected to result in a prosecutable case, may be warranted. Whatever the final decision, it is our hope that the legal and managerial lessons to be learned from the Department's experience of this investigation will not be lost.

Thank you for the courtesy of hearing our views on this matter.

cc: Jensen
Olsen
Richards
Ogren
Silverstein
Weiner

Subject
Investigation of Newport News Shipbuilding and Dry Dock Company — Work Plan for October - November 1982

Date
September 24, 1982

ECW:amb

To
Robert W. Ogren, Chief
Fraud Section
Criminal Division

From E.C.W.
Edward C. Weiner, Deputy Director
Office of Economic Crime Enforcement
Criminal Division

Branch Chief Morris Silverstein notified me officially a week ago that I was being assigned to revitalize the investigation of Newport News Shipbuilding and Dry Dock Company. Mr. Silverstein asked me to prepare a short work plan which I am submitting to you. It should be noted that no other line attorneys have yet been assigned to this matter and I am therefore proceeding alone.

1. Organization of Files.

2. Theory of Case. My view is that the case will be made if the evidence on the conspiracy to inflate claims (the company-wide conspiracy allegedly begun in 1974) can be combined with the "soft" items and the one "hard" item [redacted] (Ventilation Control Air System). Mr. Silverstein believes that additional "hard" items (specifically Discharge Sea Chests and Reactor Shielding) should be examined closely to discover "false" statements. He has instructed me to do so. This will require deep immersion in technical detail starting with the Claim Item Technical Analysis Reports (CITARs) prepared by the Navy engineers.

Possible theories of the case (not mutually exclusive) include:

a. The actual falsity theory. Hours worked, material used, and thus actual costs claimed were deliberately false. This theory would focus on 18 U.S.C. Section 287 or 18 U.S.C. Section 1001 and primarily look to the "hard" items.

b. The reckless disregard theory. Claim narratives were misleading, inaccurate, and sloppy but not blatantly false. This theory would focus on 18 U.S.C. Section 286 and look to the entire claims process involving both "hard" and "soft" items.

c. The obstruction/overburden theory. The claims effort was specifically calculated to delay and impede the orderly function of Navy procurement by piling together reams and reams of somewhat factual but meaningless jibberish. This theory could utilize either 18 U.S.C. Sections 371 or 286.

d. The lulling theory. The claim narratives were put together quickly but were re-examined by the company during the period of time that the Navy Claims Settlement Board analyzed them (1976-1978). During that period, several communications were mailed to the Navy revising parts of the claim, withdrawing some claim items, and attesting to the truthfulness of the remaining claim. This theory would focus on 18 U.S.C. Section 1341.

e. The ask-for-the-moon conspiracy theory. [redacted] the company set a specific goal of $200 million in cost overruns but [redacted] ask for four or five times that ($894 million). If an insider can be "flipped," individuals as well as the company should be prosecuted under 18 U.S.C. Section 286.

3. Game Plan.

b. Read and digest the CITARs on Discharge Sea Chests and Reactor Shielding and possibly a few other new items. Determine the appropriate witnesses and documents on these new items.

c. Pursue the allegations on the conspiracy to inflate laims:

d. Outline and organize the already-gathered evidence on Ventilation Control Air System.

EXHIBIT EE

JULY 8, 1983 -- LETTER FROM RICKOVER TO THE ATTORNEY GENERAL

8 July 1983

Dear Mr. Attorney General:

I write once more concerning the criminal investigation of the Newport News shipbuilding (TENNECO) claims. It is important that I know the status of the matter because I do not wish to take any action that might interfere with the efforts of your Department--if they are actually advancing the investigation. On the other hand, if it is not being actively advanced, I should like to know this quickly, so that I may feel free to take my concerns to another forum.

A brief summary of my interest in this matter is in order:

1. During 1977 and 1978, after consulting with the Navy Counsel to the Justice Department, I submitted several reports of apparent fraud in connection with TENNECO claims on Navy shipbuilding contracts at Newport News.

2. A Special Fraud Section in the office of the U.S. Attorney for the Eastern District of Virginia undertook, in 1978, the investigation and responsibility for the matter.

3. In November 1981, the Special Fraud Section in the Eastern District of Virginia strongly recommended prosecution in a report to the then new U.S. Attorney for the Eastern District of Virginia, the Honorable Elsie Munsell, and to the Chief Assistant Attorney General, of your Criminal Division. I was aware of this report, because members of my organization, cleared to receive such information while working with your prosecutors, received copies of the

report at the time it was completed and distributed.

4. Shortly after the report was completed, the Special Fraud Section which had prepared it was abolished by the new United States Attorney; further, the experienced prosecutors in the unit assigned to the matter were reassigned to other duties.

5. On January 13, 1982, I expressed my concern regarding the reassignment of attorney personnel in the Eastern District of Virginia to you personally. As I am sure you will recall, I advised that I could think of no better way to scuttle a complex investigation than to dismember the team conducting it and assign it new duties.

6. Shortly after expressing these concerns to you, I received copies of letters written by D. Lowell Jensen, Assistant Attorney General, Criminal Division, dated February 12, 1982, and March 11, 1982. These stated "one matter continues to be the subject of investigation and close review [Newport News]" and "The TENNECO (Newport News) investigation has not been completed and, as a result, we are unable to disclose further the status on [sic] the matter!"

7. Persons on my staff had been responsible for furnishing technical guidance to prosecutors. Because my association and contact with them continued after my retirement, it was obvious to me that no action was being taken by the Justice Department to advance the case, despite Mr. Jensen's assurance that the matter was being pursued.

8. On May 26, 1982, I urged that you staff

the TENNECO case promptly, noting that "[t]he longer the matter lasts unattended, the less likely that justice will ever be done in the matter, which may be the most massive raid on the federal treasury in the history of the United States."

9. On June 23, 1982, the United States Attorney for the Eastern District of Virginia publicly stated, "I regard both of these cases [Newport News and one other] as open cases to which we are devoting appropriate time and energy."

10. On June 24, 1982, you promised to keep me informed with regard to the Newport News investigation.

11. On July 20, 1982, I complimented your Department on its plan to establish a special unit of prosecutors in Alexandria to prosecute procurement fraud. I also urged that the Newport News case be assigned to the new unit as a high priority matter. No action by the Justice Department was apparent to me at the time I made this recommendation. However, the creation of the new unit caused me to have hope the matter would no longer be left in a position to "fall through the crack."

12. On August 20, 1982, Mr. Jensen attempted to explain the lack of action in the Newport News matter to me. He wrote:

> In the area of procurement fraud in particular, the fact-gathering investigation process is lengthened and made even more difficult due to the complexity of the subject matter. The quality of evidence proving intent to defraud that is required to bring criminal

> charges must be ferreted out of a process that relies on constructive change orders which permit change in a contract not foreseen by contracting officers, yet approved by government employees during construction.

Many tasks are complex and difficult, particularly when those responsible fail to carry out their responsibilities. After informing me how complex the task was, Mr. Jensen neglected to state what, if anything, he was doing to overcome the "complexity" and complete the task.

13. On September 8, 1982, having received Mr. Jensen's August 20, 1982, letter, I responded by again asking Mr. Jensen all of the same questions I had asked in the past; i.e., (a) why was the Justice Department neglecting the investigation, (b) why did the Justice Department repeatedly reassign personnel charged with responsibility for the matter, and (c) why was the special prosecution unit disbanded after it had strongly recommended indictment? I received no response.

14. On February 4, 1983, the Virginia Pilot reported that Justice Department officials had stated that the Newport News case was still under investigation.

15. On February 18, 1983, frustrated at my inability to reconcile the continued public statements by the Justice Department that Newport News was still under investigation with its obvious lack of progress and activity, I therefore wrote to Robert Ogren, Chief of the Department's Fraud Section, asking him to confirm that the Newport News matter was being actively pursued. Mr. Ogren never acknowledged my letter.

The question I asked Mr. Ogren in February is the same question I ask in this letter. I also request answers to the following:

a. If an attorney allows a statute to lapse, does this constitute malpractice?

b. Has the statute of limitations expired on the Newport News matter; if so, when did it expire?

c. Has the Newport News matter been actively investigated since the November 1981 report recommending prosecution, or has it languished from inattention?

d. Has the Department fully and completely investigated the case or was investigation terminated prior to completing all investigative leads. If so, why?

When I referred the Newport News matter to the Department of Justice, I was fully aware that I was asking it to undertake a difficult and complex task; also, that success could be achieved only through diligence, hard work, and interest from high Government officials. I held high hopes because I knew those assigned to the task. When they were removed before completing their task, for reasons not known to me, no one took their place.

I believe it would be plain to any disinterested observer that I should have been advised in the premises. I entrusted the matter to your Department and looked to it as a corporate client would look to its law firm for assistance, and now that my hopes have not been realized, the least you can do is have the courtesy to advise me, in detail, of your efforts in the Navy's behalf.

I believe that what I am asking you is no more than any client would expect of his lawyer.

Sincerely,

H. G. Rickover.
H. G. RICKOVER

The Honorable William French Smith
Attorney General of the United States
Washington DC 20530

Copy to:
D. Lowell Jensen
Robert Ogren
Elsie M. Munsell

EXHIBIT FF

JULY 22, 1983 -- REVIEW OF NAVY CLAIMS INVESTIGATIONS,
OFFICE OF POLICY AND MANAGEMENT ANALYSIS,
CRIMINAL DIVISION, U.S. DEPARTMENT OF JUSTICE

U.S. Department of Justice

Criminal Division

Assistant Attorney General

Washington, D.C. 20530

AUGUST 2 4, 1983

Walter T. Skallerup, Esquire
General Counsel
Department of the Navy
Washington, D.C. 20350

Dear Mr. Skallerup:

We are enclosing for your information a copy of our report "Review of Navy Claims Investigations", which has been prepared by the Criminal Division's Office of Policy and Management and Analysis. The report reviews the Department's experience with the Lockheed, Bath Iron Works, and Electric Boat investigations. We appreciate your agency's assistance in providing background information regarding these cases.

If you have any questions about the report, please contact John C. Keeney, Deputy Assistant Attorney General at 633-2621.

Sincerely,

Stephen S. Trott
Assistant Attorney General
Criminal Division

Enclosure

By: John C Keeney
John C. Keeney
Deputy Assistant Attorney General
Criminal Division

7/22/83

REVIEW OF NAVY CLAIMS INVESTIGATIONS

Office of Policy & Management Analysis
Criminal Division
U.S. Department of Justice

TABLE OF CONTENTS

Page

Executive Summary i

I. Introduction and Summary 1

  A. The Reason for the Study 1

  B. How the Study was Performed 2

  C. Summary of Findings 2

    1. Relationship of the criminal justice system to the claims process 2

    2. Management of the investigations 4

  D. Organization of this Report 5

II. The Naval Ship Procurement and Claims Processes 6

  A. Background 6

  B. General Description of Claims 7

  C. General Description of the Claims Review Process . . 10

  D. Public Law 85-804 12

  E. Description of the Claims in these Investigations . 12

  F. Characteristics of the Claims Process 16

    1. Using expert lawyers to prepare the claims . . . 16

    2. Posturing to establish negotiating positions . . 16

    3. Advancing questionable theories 17

    4. Using estimates and failing to agree on methods of proof 19

    5. Allowing contractors to back into claims figures 20

    6. 85-804 relief 22

    7. Summary of the characteristics: the claims settlement process as bargaining 23

Page

III. The Reasons for Declining the Three Closed Cases and What Those Declination Reasons Suggest for Future Cases 27

A. The Declination Reasons 27

1. Lockheed 27
a. Steel claim 27
b. Total cost recovery 28

2. Bath 28

3. Electric Boat 31
a. Unsuitable data 31
b. Delay 33
c. Lack of intent 34
d. 85-804 relief 34

B. The Reasons For Declination Are Related to Characteristics of the Claims Process 35

IV. Management of the Investigations 37

A. Supervision 38

B. Attorney and Agent Staffing 40
1. Experience in large paper cases 40
2. Attorney and agent turnover 41
3. Numbers of attorneys and exclusive attorney assignments 42

C. Relations with the Navy 43
1. Using the Navy's expertise 43
2. Using the investigations to encourage referrals that referrals that will make good criminal prosecutions and discourage those that will not . 44

D. Civil Remedies 44

V. Application of Lessons Learned from the Claims Cases . . 45

A. Navy Actitns Taken to Prevent Claims 45

B. Recommendations for Criminal Prosecution of Claims Cases 48

1. A criminal investigation should, early on, consider whether actions taken in the claims process argue against prosecution 48

Page

2. A criminal investigation should not be a second claims analysis 49

3. A criminal investigation is appropriate where there is an indication that the administrative process for analyzing a claim was corrupted 49

C. Recommendations for Management Improvements 52

D. Consideration of Legislative Change 53

E. Application Beyond Navy Claims Cases. 55

LIST OF APPENDIXES

APPENDIX A - List of Interviewees

APPENDIX B - Detailed Description of Claims and Processing of Claims in Lockheed, Bath, and Electric Boat

APPENDIX C - Detailed Histories of the Lockheed, Bath, and Electric Boat Investigations

EXECUTIVE SUMMARY

I. Introduction

The Department of Justice has investigated possible fraud in claims filed by five major shipbuilders. After extensive investigations, the Criminal Division declined to prosecute Lockheed, Bath, and Electric Boat. The Department is continuing to review the investigation of Newport News and has appealed the dismissal of the indictment against Litton. The shipbuilding investigations have raised serious concerns within the Justice Department because they were extremely lengthy and resource intensive, and three were ultimately declined. This report examines the three closed shipbuilding investigations.

II. The Naval Ship Procurement and Claims Processes

Shipbuilding contracts include "changes" clauses, which entitle a contractor to an "equitable adjustment" when the Navy contracting officer directs changes to be made that adversely affect the shipbuilders' costs or schedules. The concept of equitable adjustment for extra work caused by "directed changes" ordered by a contracting officer has been extended to "constructive changes", which originate from government actions or inactions apart from directed changes.

Shipbuilders submit claims or requests for equitable adjustment during the course of a contract, or near or after its completion. Shipbuilders may accumulate claims on one or more contracts and present them together as one omnibus, or consolidated, claim. Delay and disruption costs constitute most of a claim's value. The claims that formed the bases of the Lockheed, Bath, and Electric Boat matters were omnibus claims for many millions of dollars associated with one or more contracts.

When a contractor submits a claim, the Navy assembles a team of technical experts to review it and recommend a settlement amount. If the Navy and the contractor cannot agree on a settlement amount, the contracting officer issues a decision that the contractor may appeal.*

Several characteristics of the claims process are important to understanding why claims cases may be difficult to prosecute criminally:

- The participants in the claims process view the process largely as a negotiation in which extreme positions are taken for bargaining purposes;
- The claims are prepared by expert lawyers, who know how to establish extreme bargaining positions by inventive use of cost estimates and legal and accounting theories; and
- Contractors may "back into" claim figures by first computing how large a claim recovery they need, and then structuring the claim documentation process so that the claim submitted is roughly for the amount needed.

Partly because of the various pressures to get the matter concluded, partly because the Navy appreciates that the range of the arguably owed amount is so wide, and partly (in some instances) because the contractor threatens to stop work unless the claim is settled, the Navy and the contractor end up bargaining over the amount to be paid. In settling the claim, they may employ P.L. 85-804, which allows the government to provide relief to a contractor outside its contract when it is in the interest of national defense.

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* The Bath claims were processed through a different procedure. Bath made its claims to a private arbitration panel as a result of the procurement arrangements under which a private company was purchasing the ships from Bath and leasing them to the government. This arbitration had some, but not all, of the characteristics of the claims process. Particularly, the Bath claim was based largely upon accounting theories and cost estimates.

The claims process is, in fact, largely a negotiation, with the contractor's opening position a large number it supports through theories and estimates that are fully revealed to the Navy. This large figure can be reached without misstatements of fact. Indeed, although the claims do contain statements of fact, it is their theories and estimates that produce their enormous size.

III. The Reasons for Declining the Three Closed Cases and What Those Declinations Suggest for Future Cases

The Criminal Division declined to prosecute Lockheed, Bath, and General Dynamics because lengthy and thorough investigations revealed insufficient evidence of criminal violations. The difficulties the Department encountered included the following:

- Because years had elapsed since the construction of the ships and the preparation of the claims, memories of witnesses had faded and, in a few instances, key individuals had died;
- The division of responsibility within each shipyard made it difficult to identify employees who had complete knowledge of the questionable parts of the claims, and who could be held accountable for their accuracy; and
- The technical and accounting issues raised in claims investigations often promised battles of experts at trial that would have made it difficult, if not impossible, to convince a jury of laymen that the government had presented proof beyond a reasonable doubt.

More importantly, the Department discovered that, in many ways, the characteristics of the claims process itself frustrate criminal prosecution. A prosecution for a false claim, false statement, or conspiracy to defraud the government generally assumes that the defendant has deliberately made false statements of fact or otherwise employed deceitful or dishonest means against the government. It is possible, however, for contractors and their attorneys to construct huge shipbuilding claims by manipulating theories of entitlement and cost estimates — without making positive misstatements of facts and without concealing what they have done.

One can trace the Criminal Division's decisions not to prosecute Lockheed, Bath, and Electric Boat largely to the difference between the premises of a criminal prosecution and the realities of the Navy claims process. The criminal investigations devoted considerable attention to the creative (and sometimes questionable) contractor theories and cost estimating and accounting techniques, in effect reanalyzing the claims. Although the investigations identified questionable theories and loose estimates of the additional costs caused by government actions during ship construction, they did not, in the judgment of the Criminal Division, identify the sort of conduct appropriate for criminal prosecution.

IV. Management of the Investigations

At the outset of these investigations the Fraud Section did not recognize how large and complex these matters would become or how difficult proof of criminality would be given the nature of the Navy claims process.

The Division did not direct concentrated management attention to these cases until an indictment review meeting or when a problem arose. In addition, there were problems with attorney and agent staffing. Although it was clear that Navy assistance was needed in these cases, there was no consensus on how a criminal investigation should be staffed to use the assistance best. The Division tried a variety of arrangements to tap Navy expertise, none of which was completely satisfactory. Although the Civil

Division reviewed the Lockheed, Bath, and Electric Boat matters, there was not, at the time these cases were referred, any established procedure for keeping the Civil Division apprised of the cases or discussing what role civil sanctions should play.

We are not suggesting that the ultimate outcomes of these cases would have been different if there had been tighter management controls. Nonetheless, the experience gained from these investigations may help improve the management of future cases.

V. Application of Lessons Learned from the Claims Cases

A. Navy Actions Taken to Prevent Claims

Over the course of many years, the Navy has reviewed the growing problem of claims and has taken numerous steps to avoid or reduce them. These have included changing acquisition practices and contract clauses to shift additional risk to the government; instituting contract administration procedures to minimize constructive changes; and regulating the submission of claims and the claims review process. The effect of these developments is to decrease the probability that the Navy will refer major shipbuilding claims matters to the Justice Department in the future.

B. Recommendations for Criminal Prosecution of Claims Cases

If a new omnibus claim does reach the Justice Department, it might still bear some of the characteristics that made prosecution difficult in the Lockheed, Bath, and Electric Boat cases.

The Division's experience with the Lockheed, Bath, and Electric Boat matters leads to several basic conclusions about the role of criminal prosecution in the claims area.

- A criminal investigation should not be a second claims analysis;

- A criminal investigation should, early on, consider whether actions taken in the claims process argue against prosecution; and
- A criminal investigation is appropriate where there is an indication, such as a deliberate misrepresentation, that the administrative process for analyzing a claim was corrupted. Contractor actions that increase the possibilities for a successful criminal prosecution include:
  - alteration of records;
  - destruction of records;
  - failure to keep records that a legitimate business would keep;
  - creation of phony back-dated records;
  - signals by management to the employees preparing the claim that they should include false statements; and
  - secret conspiratorial meetings at which company executives decide to submit false statements of fact.

C. Recommendations for Management Improvements

Recommendations for improving the management of such cases in the future flow directly from the difficulties encountered in these cases. The Department should apply management review procedures to screen claims matters when they are referred and to monitor their progress if they are pursued. Claims cases should not be undertaken unless they involve some of the indicia of criminality set out above or unless the Department is otherwise satisfied that a prosecution would be possible, given the nature of the claims process. If a future case is accepted, the Defense Procurement Fraud Unit, with its special expertise, will probably be in a good position to staff it.

If the Department decides to pursue an investigation, management should approve an investigation plan.* The plan should address questions of attorney and agent staffing, how Navy expertise can best be used, and what the focus of inquiry should be. The plan should include periodic reviews by supervisors and schedules for accomplishing the major tasks in the investigation. If an investigation terminates without indictment, the Department should explain to the Navy why it sought no indictment and offer recommendations for future referrals.

D. Consideration of Legislative Change

The complexity of shipbuilding firms and the division of labor within them can frustrate the prosecution of individuals. If only a corporation can be prosecuted, then a fine is the only direct sanction available following a conviction. The fine will likely be in an amount that is insignificant in relation to the amount of money involved in the claim. A related civil case could recover a larger amount, but in a case such as Electric Boat, where the government paid 85-804 extra-contractual relief in the interest of national defense, a large civil recovery would simply place back in the government's pocket part or all of the amount paid voluntarily out. The Division should consider the question of whether available civil and criminal sanctions against corporations are adequate and whether legislation embodying additional sanctions should be proposed.

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* The Fraud Section of the Criminal Division has adopted additional management controls since the completion of these investigations, which incorporate many of the steps suggested here.

I. Introduction and Summary

A. The Reason for the Study

The Department of Justice has investigated possible fraud in claims filed by five major shipbuilders: Lockheed Shipbuilding and Construction Company, Bath Iron Works, Electric Boat Division of General Dynamics, Newport News Shipbuilding, and Litton Systems, Inc. d/b/a Ingalls Nuclear Shipbuilding Division.* After extensive investigations, the Criminal Division declined to prosecute Lockheed, Bath, and Electric Boat. The Department is continuing to review the investigation of Newport News and has appealed the dismissal of the indictment against Litton.

These investigations have raised serious concerns within the Criminal Division, the investigative agencies (the FBI and the Naval Investigative Service (NIS)), and other parts of the Navy because they were extremely lengthy and resource intensive, and three were ultimately declined. Therefore, in the letters informing the FBI and the Navy of the Bath and Electric Boat declinations, the Division promised to study the shipbuilding matters.

> "We are planning to assemble the prosecutors, investigators, and Navy attorneys who have claims investigation experience to address the problems incurred during their investigation and we will attempt to identify possible program as well as procedural improvements which will make the Navy claims program and our investigation support more effective" (Electric Boat declination letters from D. Lowell Jensen to Director of the FBI and General Counsel of the Navy, Dec. 18, 1981).

This report is the product of that study.

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* The U.S. Attorney's Office in the Eastern District of Virginia handled the Newport News and Litton matters in conjunction with the Criminal Division.

Newport News Shipbuilding is a subsidiary of Tenneco. Lockheed Shipbuilding and Construction Company is a subsidiary of Lockheed Aircraft Corporation.

B. How the Study was Performed

In order to avoid the appearance of interference in the open Newport News investigation and the Litton case, the study focused on the closed investigations of Lockheed, Bath, and Electric Boat.* The study team:

(1) read background material describing and commenting on the shipbuilding industry, the Navy acquisition process, and the claims process;

(2) reviewed the Criminal Division files for the three closed investigations;

(3) interviewed the principal Criminal Division attorneys and FBI and NIS agents who worked on the three closed investigations and some of their supervisors;

(4) interviewed some of the past and present participants in the Navy acquisition process and the claims process; and

(5) interviewed attorneys in the Civil Division who examined the civil potential of these three matters.

Appendix A lists the interviewees.

C. Summary of Findings

1. Relationship of the criminal justice system to the claims process

A prosecution for a false claim, false statement, or conspiracy to defraud the government generally assumes that the defendant has deliberately made false statements of fact or otherwise employed deceitful or dishonest means against the government. However, because the amount of a shipbuilder's claim is so greatly dependent upon theories of entitlement and cost estimates, it is possible for shipbuilders and their attorneys to construct huge claims by manipulating the theories and estimates — without making false statements of fact, without concealing what they are doing, and without engaging in other activities (e.g., bribery, alteration of documents) that warrant criminal prosecution.

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* Conversations with some of the prosecutors familiar with the Newport News investigation and the Litton case indicate that our findings are consistent with the experience in these open matters.

One can trace the Criminal Division's decisions not to prosecute Lockheed, Bath, and Electric Boat largely to the difference between the premises of a criminal prosecution and the realities of the Navy claims process. The criminal investigations devoted considerable attention to the creative (and sometimes questionable) contractor theories and cost estimating and accounting techniques, in effect reanalyzing the claims. Although the investigations identified questionable theories and loose cost estimates, they did not, in the judgment of the Criminal Division, identify the sort of conduct appropriate for criminal prosecution.

If the Department (either the Criminal Division or a U.S. Attorney) receives a new referral for criminal prosecution from the Navy arising out of claims submissions, the Department should review it carefully at the outset to determine whether it is or can be focused on either misrepresentations of facts the contractor included in the claims submission or other indications that the process for reviewing claims was corrupted (e.g., by bribery). If the Department cannot focus the referral in this way, it should decline the matter for criminal prosecution, and consult with the Civil Division to determine whether the case might have civil potential. If the Department accepts the referral, it should ensure that it applies management controls, such as those set out below, so that the investigation retains its focus.

2. Management of the investigations

The investigations, which were large and complex, encountered some management difficulties. In the early stages of the investigations there was little active supervision of attorneys. There were problems with attorney and agent staffing patterns. We are not suggesting that the ultimate outcomes of these cases would have been different if there had been tighter management controls. Nonetheless, the experience gained in these cases may help improve the management of future cases. The Department should supervise any future claims investigation more closely by applying management review procedures to monitor investigation progress from the outset. At the beginning of the investigation, management[*] should develop a plan that addresses the number and level of experience of attorneys and agents on the matter, the manner in which the Navy can use its expertise to assist the investigation, and the focus of the inquiry. The plan should include a timetable that, among other things, specifies when Department supervisors will review the investigation's progress. At each review, management should attempt to define the factual investigation and legal research goals for the investigative team to achieve before the next review. If the investigation terminates without indictment, management should explain the reasons to the Navy in a way that encourages future referrals of matters that have significant potential for criminal prosecution and discourages others.

During the past year, the Fraud Section of the Criminal Division has instituted a number of case management techniques that would apply to future claims cases and accomplish many of these objectives. Nonetheless, the claims cases are unique in size and complexity. If the Section launches similar investigations in the future, it will need special efforts to ensure that it applies these management techniques with sufficient determination to bring such overwhelming undertakings under control.

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[*] To the extent future investigations are handled by the Fraud Section or its new Defense Procurement Fraud Unit, "management" refers to the Fraud Section and its supervisors in the Criminal Division. To the extent future investigations are handled by U.S. Attorneys' Offices (USAOs), "management" refers to the supervisors in those offices. Where the Fraud Section and a USAO conduct a joint investigation, the Fraud Section should provide the management (see p. 40 below).

D. Organization of this Report

The study emphasizes how the characteristics of the claims process, as administered by the Navy, complicate criminal prosecutions. These differences were in large part responsible for the Division's decisions to decline the Lockheed, Bath, and Electric Boat matters.

The following section (II) describes the shipbuilding industry; the recent history of Navy acquisition practices; the claims process generally; the nature of the claims submitted by Lockheed, Bath, and Electric Boat; and the manner in which the Navy handled those claims. Section II concludes with a discussion of some of the characteristics of shipbuilding claims and the Navy's processing of them. Section III sets out the reasons for declining to prosecute these three shipbuilders and relates those reasons to the characteristics of the claims process set out in Section II. Section IV discusses the management of the investigations, including the role of civil remedies. Section V considers the application of lessons learned from the Lockheed, Bath, and Electric Boat investigations to future Navy claims referrals and beyond. The section describes Navy actions taken to prevent claims; offers principles that may assist the Department in determining whether it should pursue future referrals; suggests how the Division should manage claims investigations of accepted referrals; and points out the particular difficulties in obtaining effective sanctions in claims cases.

II. The Naval Ship Procurement and Claims Processes

A. Background

The Navy initiated a major shipbuilding program in the 1950s to modernize its fleet of combatant ships. In the early stages of the program, the Navy divided new construction among approximately 20 private shipyards and U.S. naval shipyards. As time went on, the effort relied increasingly on private shipyards. In 1967, the Navy assigned its last new ship to a naval yard. Since then, the Navy's construction effort has depended completely on private industry. The shipbuilding industry today is highly concentrated. Eleven privately owned shipyards currently build new Navy ships. Three yards control the majority of Navy construction. Only two (Electric Boat and Newport News) are currently building nuclear ships and one other (Litton) is performing nuclear repair.

Until 1964, the Navy awarded shipbuilding contracts primarily by allocation, in the interest of maintaining a broad shipbuilding mobilization base. The Navy generally used fixed-price contracts for these acquisitions. Procurement policy changed in 1964, when the Navy began to solicit competitive bids in the selection of contractors and to write firm fixed-price contracts (such as the Lockheed contracts). Several years later, the Navy began to use fixed-price incentive contracts (such as the Electric Boat contracts) entered into after competitive negotiation.

In the early 1970s, a number of unforeseen events such as labor problems,* increasing inflation,** material shortages, and the oil embargo resulted in significantly higher construction costs. The cost effects of these events were amplified for shipbuilders who had priced their work four to seven years ahead of performance. The length of time required to construct a single ship and the use of multiple-ship contracts led to serious cost overruns for many of the yards. Shipbuilders tried to recover these unanticipated costs by filing claims, arguing that government actions caused some or all of the extra costs. The size and scope of the claims increased dramatically. By the spring of 1978, the value of outstanding claims against the Navy totaled approximately $2.7 billion.

B. General Description of Claims

The Navy often awards shipbuilding construction contracts before all the detailed working plans for construction have been developed, and invariably makes changes to the original contract specifications for the design and construction of ships. Since the detailed working plans and design modifications can change a shipbuilder's contractual obligations, the ability to modify a shipbuilding contract through the change process is essential to the Navy. Shipbuilding contracts include "changes" clauses, which entitle the shipbuilder to an "equitable adjustment" when the contracting officer, by written order, makes changes that adversely influence the shipbuilder's costs or schedules in the drawings or specifications in the method of shipment or packing, or in the place of delivery. Such changes are often referred to as "directed changes."* The concept of equitable adjustment for extra work, embodied in the directed changes clause, has been extended to "constructive changes,"** which include changes that have originated from government actions or inactions apart from directed, or written, orders but which have the legal effect of directed changes. Both the Navy and the shipbuilder agree that a directed change is a "change" in contractual obligations at the time it is made. In contrast, one or both parties may not understand, at the time it is taken, that the action constituting a constructive change has changed contractual obligations.

---

* In contrast to many other large scale industrial enterprises, shipbuilding is extremely labor-intensive. It is also highly dependent on a relatively large proportion of skilled craftsmen, such as welders, shipfitters, and electricians. Shipbuilders have found it difficult to recruit, train and retain skilled workers, and to develop a manpower pool sufficient to expand operations. The major reasons for the problem appear to be: the inability to assure continuing work; reliance on labor skills transferable to other areas of the construction industry, compounded by wage differentials and unattractive working conditions; and an immobile labor force that has frustrated attempts by expanding shipyards to attract skilled workers from other areas.

** Until 1975, the Navy's contracts generally included escalation clauses to account for inflation, but did not permit escalation to account for inflation occurring after the ship delivery dates specified in the contracts.

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* Even though the Navy and the shipbuilder concur that a directed change constitutes a change for which the Navy is responsible, they may disagree over the amount of equitable adjustment to which the shipbuilder is entitled as a result. It is Navy policy to seek an agreement with a shipbuilder on the scope and price of a change before executing a change. The Navy prefers modifications that are fully priced supplemental agreements, including a release from future claims. Modifications may, however, contain only maximum prices or they may be partially priced, reserving some aspect of the equitable adjustment (such as related delay and disruption costs) for resolution at a later date. A contracting officer is supposed to use a unilateral change order only when it is not possible to reach an agreement with the shipbuilder before the change must be implemented.

The changes clause provides that if the Navy and the shipbuilder fail to agree on an equitable adjustment, the shipbuilder must continue performance of the contract as changed. Under such circumstances, the shipbuilder has a right to obtain a determination concerning the amount of equitable adjustment under the "disputes" clause of the contract.

** As defined in the 1978 Naval Ship Procurement Study, a constructive change is "a course of conduct (which may include actions, inactions, and written or oral communications) by the contracting officer or an authorized representative that causes the shipbuilder to perform additional or different work than what is required by the contract terms" (p. 228). The shipbuilder initially identifies the constructive changes and presents them to the Navy as a request for additional compensation. If the Navy agrees with the shipbuilder that a change has occurred, and that the Navy is responsible, the change is treated as a directed change and is handled by the process described in the footnote above. There are three major categories of constructive changes: (1) defective or ambiguous drawings or specifications; (2) communications and interpretations during the ship construction cycle; and (3) failure of the government to meet its contractual obligations.

Delay and disruption costs constitute the vast bulk of the value of most ship claims.*

Delay costs are those incurred by the shipbuilder as a result of slippages in the delivery date caused in whole or in part by one or more directed or constructive changes. The delay may cause the contractor to incur additional costs in the performance of original contract work at a later date and additional costs for support services in the period beyond the scheduled completion date. Calculating delay costs is generally more complicated than determining the direct cost of the change itself. Contractors have often submitted a total cost claim asserting, in effect, that the government is responsible for the entire delay (GAO, "Shipbuilders' Claims — Problems and Solutions," 1977, p. 13). It is difficult for the government to isolate the alleged reasons for the delay and the excess costs caused by government actions when the facts indicate that contractor actions also contributed to the delay.

Disruption costs are those incurred by the shipbuilder when planned work must be redone or rescheduled because of changes. These costs reflect the loss or reduction in productivity because of changes in the sequence, length of time, or level of staffing of any given task. Disruption costs are unquestionably the most difficult to compute. Disruption is often the result of numerous factors, some for which the government is responsible, others for which it is not. In its claim, the contractor may present a total cost claim for disruption, arguing that all disruption costs are caused by government changes.

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* One study estimated, in 1978, that the delay and disruption portion of a claim constituted 88-90% of the value of that claim. (Klinkhamer, David J. and Pence, Derry T., "CGN 41: A Case Study of Ship Procurement," March 1978, thesis, Naval Postgraduate School, Monterey, California, p.120)

C. General Description of the Claims Review Process

Shipbuilders submit claims or requests for equitable adjustment during the course of a contract, or near or after its completion. Shipbuilders may accumulate claims on one or more contracts and present them together as one omnibus, or consolidated, claim. When a contractor files a claim, the Navy assembles a team of engineering, auditing, and legal experts to study it and make recommendations about the appropriate settlement amount.* The team may request additional information from the contractor concerning the claim, but the Navy has no legal right, during the claim evaluation, to all contractor documents. The team's proposed settlement amount reflects the amount the Navy believes it certainly owes, plus an amount for litigative risk* and cost. Litigative risk amounts are not automatically included in settlement offers but they are considered by the Navy in establishing its pre-negotiation settlement ceiling. The offer may take the form of a proposed contract repricing rather than simply a cash payment. If a negotiated settlement is not reached, the contracting officer issues a decision that the contractor may appeal. At the time of the Lockheed and Electric Boat claims, litigation on the contracting officer decision could go forward before the Armed Services Board of Contract Appeals (ASBCA) and Court of Claims. The procedures for litigating contracting officer decisions has since been somewhat changed by the Contract Disputes Act (41 U.S.C. 601 et seq.)** and the Federal Court Improvement Act of 1982 (P.L. 97-164, 96 Stat. 25).

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* The teams can be quite large. Admiral F.F. Manganaro, Chairman of the Navy Claims Settlement Board, testified that in analyzing the Newport News claims he had "a number of engineers and attorneys which varied between a low of about 10 to a high of about 40" and that a maximum of 20 to 25 worked on the Electric Boat claim (U.S. Congress, Joint Economic Committee, Hearings on Economics of Defense Procurement: Shipbuilding Claims, Part 1, 94th Cong., 2nd Sess. and 95th Cong., 1st Session, pp. 139-140).

A memorandum written by Admiral Rickover in February, 1974 stated that, in December, 1973 "the special claims group [evaluating Litton's claim] at Pascagoula alone had about 70 people, 40 clerical and 30 professional" (reproduced in U.S. Congress, Joint Economic Committee, Hearings on Economics of Defense Policy: Adm. H.G. Rickover, Part 4, 97th Cong., 2nd Sess., p. 88). Navy Assistant Secretary Hidalgo testified in 1978 that the Litton claims analysis team had been supported by numbers of people "ranging from 160 to 200" (U.S. Congress, House, Armed Services Committee, Hearings on the Navy Proposal to Modify SSN-688 Contracts with the General Dynamics Corp. (Electric Boat Division) and LHA and DD-963 Contracts with Litton Industries, Inc./Litton Systems, Inc. (Ingalls Shipbuilding Division), 95th Cong., 2nd Sess., p. 205).

It probably is difficult to obtain a single number that satisfactorily reflects the Navy manpower devoted to the analysis of a major claim, because parts of the analysis may be undertaken or assisted by different parts of the Navy.

Although the Lockheed and Electric Boat claims were processed through these Navy procedures, the Bath claims were not. In that case, a private company was purchasing the ships to lease them to the government under charter rates that would, among other things, reimburse the private company for any claims that Bath asserted. Under the terms of the construction contract, Bath made those claims in private arbitration against the private purchaser.

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* The litigative risk estimate is a judgment of how much more the Armed Services Board of Contract Appeals (ASBCA) or the Court of Claims (now the Claims Court) might award beyond the amount the Navy determines that it certainly owes. The ASBCA and the Court of Claims have historically provided awards more generous than those in the contracting officers' decisions.

** The Contract Disputes Act applies to claims on contracts entered into 120 days after its enactment on November 1, 1978, and to contracts entered into before that date where the contractor elects to proceed under the Act.

D. Public Law 85-804

While the claims process can settle disputes arising out of the contract as written, P.L. 85-804 provides for relief outside of the contract when it is in the interest of national defense. P.L. 85-804, codified at 50 U.S.C. 1431, provides that contracts may be amended or modified "without regard to other provisions of law relating to the making, performance, amendment, or modification of contracts, whenever [the President] deems that such action would facilitate the national defense." When the Executive contemplates use of the law to obligate an amount in excess of $25 million, it must notify the Armed Services Committees, and either house can prevent the Executive action by adopting a resolution within 60 days of the notification (ibid.). *

E. Description of the Claims in these Investigations

The claims that formed the bases of the fraud investigations in Lockheed, Bath, and Electric Boat were consolidated, or omnibus, claims. Each claim attempted to recoup at one time, and through one proceeding, most or all of the government-caused extra costs associated with a particular contract or contracts. The claims were for many millions of dollars allegedly incurred as a result of constructive changes made by the government. The claims were voluminous and filled with technical detail.

The table on the next page provides some of the particulars on these claims. As the table shows, the contractors filed these enormous claims years after the Navy awarded the contracts on which they were based, and years were consumed in the processing of the claims.**

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* The statute and Executive Order No. 10789 issued to implement 85-804 contain several other safeguards.

** A criminal investigation sometimes slows final Navy disposition. For example, the Litton claim presently is in the Claims Court. That proceeding is, however, stayed pending final resolution of the related criminal prosecution.

	Type of Ship	Amount of Claim	Time Contracts Awarded	Time Claims Submitted	Time Referred to Justice	Time Claims Disposed of	Time Justice Declined
Lockheed	Destroyer Escorts and Amphibicus Transport Dock Vessels	Approx. $130 to $160 million	1963, 1964, 1965	Late 1968 and early 1969	Dec. 1974	May 1975 (ASBCA decision)	Fall 1979
Bath	Small Oil Tankers	Approx. $19 million	June 1972	Sept. 1975	Early 1978	Jan. 1980 (arbitration award)	January 1982
Electric Boat	Nuclear Submarines (SSN 688 class)	Approx. $544 million	Jan. 1971 Oct. 1973	Dec. 1976	Early 1978	June 1978 (claims settlement coupled with 85-804 relief)	December 1981

Appendix B provides more detail on the content of the Lockheed, Bath, and Electric Boat claims, and the manner in which they were processed. It is difficult to capture, in text or chart, however, the overwhelming size of these claims and of the Newport News and Litton claims. They were larger than any the Navy had ever processed, and, when referred for criminal investigation, they were among the most complex fraud cases the Criminal Division had ever handled.

The size and scope of the claims were in part reflected in the special bodies that the Navy created to evaluate them and the confusion in the Navy's review process. The first Naval Ship Systems Command (NAVSHIPS) examination of the Lockheed claim led to a tentative agreement to settle for $62 million, but a review board in the Naval Material Command (NAVMAT), of which NAVSHIPS was a part, refused to approve it. NAVSHIPS then worked on the claim again, again recommended approval of a $62 million settlement, and was again refused by NAVMAT (although, by this time, the name and composition of the NAVMAT review body had changed). NAVSHIPS then issued a contracting officer's decision to award $7 million, which Lockheed appealed to the ASBCA, consolidating that appeal with an earlier ASBCA case challenging the failure to implement the $62 million settlement. The ASBCA decided that the Navy was bound by the $62 million settlement.

Although the Bath claim remained before one panel of arbitrators, it too suffered from delay and confusion. The panel met for only three to six days per month. Discovery proceeded simultaneously with testimony and the parties could not recall witnesses. As a result, some witnesses were examined before all of the documents relevant to their testimony were produced.

The Navy initially assigned the December 1976 Electric Boat claim to the Navy Claims Settlement Board, a body specially created to examine this claim and one filed by Newport News for $894 million. The Navy then removed the claim from that Board and transferred it to a Special Steering Committee under an Assistant Secretary for settlement in connection with 85-804 relief, but subsequently transferred the claim back to the Board, which recommended a settlement award of $125 million. After Electric Boat not only refused to accept that offer but threatened to stop all work on Navy construction, the Assistant Secretary's office stepped into the picture again and settled the claim for $125 million plus $359 million in 85-804 contractual modification.*

By the time the Navy referred these claims to Justice, they were highly publicized and politically controversial. The Navy had settled a claim with Todd Shipbuilding in March 1969, for $96.5 million. In the wake of that settlement, the Joint Economic Committee held hearings on Navy claims, and the GAO issued a report critical of the Todd settlement and the $62 million tentative Lockheed settlement. The Joint Economic Committee hearings on Navy claims ran, off and on, for several years. Senator Proxmire suggested that there might have been fraud or corruption in the Lockheed settlement. When the Navy referred the Lockheed matter to Justice, Senator Proxmire issued a press release stating that he had urged the Navy to take this step. Similarly, the Electric Boat referral occurred after Admiral Rickover testified before the Joint Economic Committee and publicly declared that he had submitted a report urging a criminal investigation of 18 items in the claim.

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* Pursuant to this settlement, Electric Boat agreed to absorb a $359 million loss, an amount equal to the 85-804 relief it was granted. In addition, Electric Boat released its right to make certain claims, including any claim that government actions on the 688 contracts, up to the date of the settlement, increased costs on the Trident contract. The settlement also included provisions for sharing cost overruns and underruns after contract modification and for increasing government payments if inflation above a certain specified amount increased Electric Boat's loss on the contracts beyond the projected loss on which the settlement was based.

F. Characteristics of the Claims Process

The following characteristics of the claims process* are particularly important to understanding why claims cases may be difficult to prosecute criminally.

1. Using experts lawyers to prepare the claims

Expert claims lawyers prepared each of these claims. The law firm of vom Baur, Coburn, Simmons & Turtle assisted in the preparation of both the Lockheed and the Bath claims. F. Trowbridge vom Baur is a former General Counsel of the Navy. Sellers, Conner & Cuneo assisted in the preparation of the Electric Boat claim. The Sellers firm is another well known claims firm, and today it includes a former chairman of the ASBCA.

2. Posturing to establish negotiating positions

Contractors include in their claims not only requests based on "hard" numbers and well-recognized theories, but requests based on grounds they know to be only barely arguable. They do this to establish a negotiating position. Contractors sometimes expressly refer to this negotiating process. For example, the Newport News claim stated:

> "We do not represent this proposal as being a balanced portrayal of both sides of the picture; however we believe that it contains sufficient information for the Navy to develop a negotiating position and recognize that it has a duty to equitably adjust the contract" (Management Summary, Proposal for Equitable Adjustment of Contract N00024-69-C-0307 for Construction of SSN686 and SSN687, Newport News Shipbuilding, July 1976, p. 45).

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* Because the Bath claim was arbitrated, it did not share all of these characteristics. However, as did Lockheed and Electric Boat, Bath employed a sophisticated law firm to construct its claim, and the claim figure was largely the product of the accounting theories and cost estimates that Bath employed.

Based on its experience, the Navy can recognize extreme contractor positions set out for negotiation purposes and it may discount initial contractor submissions accordingly. Indeed, the ability of Navy evaluators to discount the initial submissions allows Navy claims personnel to lower their "payout rates" — cents paid per dollar of a claim — which, in turn, may serve them well within the Navy and may serve the Navy well in its appearances before Congress. In hearings before the Joint Economic Committee on December 19, 1972, Representative Barber Conable had this exchange with Gordon Rule (then Director, Procurement Control and Clearance Section, Material Command, Department of the Navy) about bargaining in the claims process:

> Conable. "So people are taking bargaining positions on both sides?"
>
> Rule. "Sure, that is right."
>
> Conable. "And, of course, on both sides there is a constituency that has to be dealt with. If it is hoped to get $50 million out of the contract the company is very likely to say 'we are owed $100 million,' the Government is very likely to say 'We owe you $25 million,' and then when they settle at $50 million each one can point to the result with some satisfaction in dealing with the Joint Economic Committee, in dealing with the stockholders, and in dealing with the taxpayers. Every constituency is happy." (U.S. Congress, Joint Economic Committee, 92nd Cong., 2nd Sess., Hearings on the Acquisition of Weapons System, Part 6, pp. 1914-1915).

3. Advancing questionable theories

Contractors present all kinds of legal theories in their claims, some tested, others not.

Electric Boat asserted that drawing plans received from Newport News, the lead yard and design agent, were unsuitable in ways that were not anticipated at the time Electric Boat submitted its bid for the second series of SSN 688 submarines it constructed (Flight II). Electric Boat made this claim despite the fact that not only had it received many of the "unsuitable" plans before making the Flight II bid, but the company had actually used the plans before the Flight II bid in the construction under the Flight I contract. To justify its claim under these circumstances, the company advanced the theory that, for purposes of determining what unsuitability the company anticipated at the time of the Flight II bid, the company was entitled to rely on the knowledge of only the bid estimators and was entitled to ignore the knowledge of its employees who had been working with the plans on the Flight I construction:

> "This claim covers only that additional work scope which was not in fact known by the person responsible for making the estimate of the item or area involved" (Claim for Equitable Adjustment of the Contract Amounts and Delivery Dates, Contract N00024-74-C-0206 (688-II), Vol. 1, Pt. 1, p. 2-11).

Electric Boat also contended that the government should pay for the cost effects of all of the delay in construction of the SSN 688 submarines even though the company acknowledged that it had encountered many problems during construction, including low productivity from inexperienced workers. During the criminal investigation, Electric Boat interpreted its claim as taking the legal position that, under the circumstances, the contractor did not have to relate individual government actions to particular periods of delay. Electric Boat argued that its claim was based on the theory that the cumulative effect of multiple government-responsible actions -- particularly failures by the government's design agent to supply timely and accurate working plans -- was the predominating cause of delay, and that Electric Boat could have met its delivery schedule had the government actions not occurred. Electric Boat argued that it could hold the government legally responsible for all of the delay through this "predominating cause" theory, without offering the kind of cause and effect proof that would isolate particular portions of delay caused by particular government actions and separate those from any delays caused by Electric Boat's own problems. While the government would have argued against this position had the claim gone to litigation, Electric Boat could point to at least some legal authority to support its position (International Aircraft Services, Inc. (1965) 65-1 CCH BCA ¶ 4793, p. 22, 762; Krauss v. Greenberg (3 Cir. 1943) 137 F. 2d 569, 572).

4. Using estimates and failing to agree on methods of proof

The ASBCA has stated that:

> "It is simply not possible to prove the amount of an equitable adjustment for a constructive change with mathematical precision. In developing such a claim, a contractor must rely on estimates, which, in turn, allows considerable leeway for negotiation" (Fischbach & Moore International Corp. 77-1 CCH BCA, ¶ 12, 300, p.59, 231, quoted at p. 4 of GAO, "Shipbuilders Claims - Problems and Solutions," 1977).

To the extent that a shipbuilder submits a claim prior to the completion of a project, a contractor will necessarily rely on estimates for his projected costs to completion. Even for work completed, the contractor often uses estimates for pricing constructive changes and consequent delay and disruption. The Navy's Ship Acquisition Policy Manual notes that:

> "* * * no current private shipyard accounting system can produce return costs on hardcore changes, much less the cost associated with delay and disruption. In fact, a shipyard generally would not possess significantly more information at ship completion upon which to estimate the cost of the change, than would be available at the time the change was ordered" (Naval Sea Systems Command (NAVSEA) Ship Acquisition Policy Manual, 28 July 1981, "Release of Claims Clause," p.V-46).

In many of the claims involved in the referrals, the contractor relied on estimates because the Navy did not require, and the shipbuilder did not have, cost accounting systems that might have measured costs associated with constructive changes. Even where a shipbuilder has a good cost accounting system, it is not necessarily used for claims calculations. Bath, which purportedly had the best cost accounting system in the industry, relied on estimates of cost impacts to support some of its claims, even though the actual cost figures showed that the claims were worth a great deal less than did the estimates. Bath was free to argue that even its sophisticated system could not capture all additional costs resulting from government changes, and some of our interviewees believe that no system could do so.

5. Allowing contractors to back into claims figures

A contractor may file a claim after substantial construction has been completed and the contractor has projected, through to contract completion, large cost overruns. At that time, the contractor may assemble a large claims team to search the record back through the time of contract negotiations to locate every government act or omission that it could conceivably characterize as a constructive change, and estimate the cost impact of each. In the spirit of negotiation described earlier, a contractor may be tempted to stretch facts or, more likely, to be over-generous in cost impact estimations or indiscriminate in its choice of recovery theories in order to make the claim as large as the overrun. Contractors may submit total cost claims to the Navy, making a blanket assertion that the government is responsible for all costs without any attempt to show a cause and effect relationship between specific government actions and specific additional costs. A total cost approach may be used for a portion of a claim, like delay or disruption, or for the entire claim.*

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* The Navy Contract Directives state that total cost claims should be rejected unless the contractor can prove that there is no feasible alternative that would allow it to show that particular government actions caused particular costs. The Directive roughly parallels Court of Claims (now Claims Court) rules:

(Footnote continued on next page.)

Even if a claim does not fall within the technical definition of a "total cost claim", it may be constructed in a manner that is similar because the contractor backed into its figures. For example, in Ingalls Shipbuilding Division Litton Systems, Inc. (ASBCA (1976) 1976-1 CCH BCA, ¶11,851), the ASBCA discussed a Litton document written at the outset of a claims preparation effort. The document stated that Ingalls' Director of Division Planning had stated at a staff meeting that:

> "'a. It is impossible to re-generate the original bid by account, and it would be of no benefit to Ingalls to do this. A gross discrepancy exists between the bid and the true world. It is also impossible to allot loss of learning by account, and it is impossible to state which account has been impacted by late [government-furnished] equipment.
>
> 'b. Division planning will provide an estimate of manhours to complete the contract. This estimate will be compared with the original of total manufacturing manhours to do the contract, and the difference will be justified in a saleable manner. The difference can be broken down and justified by account'" (id., p. 56,726) (emphasis added).

The ASBCA found that the subsequently filed Litton claim was not a "total cost" claim because it was based upon "the impact of the [contract] extension, delay and disruption on [Ingalls'] labor, material and related

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(Footnote continued from previous page.)

> "This [total cost] theory has never been favored by the court and has been tolerated only when no other mode was available and when the reliability of the supporting evidence was fully substantiated.
>
> [Citations omitted.] The acceptability of the method hinges on proof that (1) the nature of the particular losses make it impossible or highly impracticable to determine them with a reasonable degree of accuracy; (2) the plaintiff's bid or estimate [of costs] was realistic; (3) its actual costs were reasonable; and (4) it was not responsible for the added expenses. [Citations omitted.]" (WRB Corporation (1968) 183 Ct. Cl. 409, 426).

costs" (p. 56,726), as computed by "estimates rather than segregated costs, in keeping with the general practice in the industry at that time" (p. 56,727). The Board added that:

> "The [staff] meeting [summarized in the memorandum] * * * was merely a starting point in the preparation of the claim. The use of a total cost method as a starting point is not objectionable per se. Boyajian v. United States [14 CCF ¶83,467], 191 Ct. Cl. 233, 247 (1970)" (p. 56,726).
>
> "Even if [Ingalls] did back into a predetermined, total cost claim figure, as the Government contends, we are not thereby barred from considering the computation of [its] claim on its merits" (p. 56,727)(emphasis added).*

6. 85-804 relief

At the 85-804 hearings for Electric Boat, Navy Secretary W. Graham Claytor, Jr., described the delay and disruption problems caused by government furnished information, and then told Congress that the claims process could not adequately handle such claims.

> "The delay and disruption caused by late Government Furnished Information (GFI) supplied by the Navy design agent warranted recognition beyond that obtained through strict claims analysis. The inherent difficulties of documenting and analyzing disruptions are well understood in government and the shipbuilding industry. The lateness of GFI early in the program particularly as it impacted Electric Boat as the follow-on shipbuilder, undoubtedly created a disruption problem that is real despite an inability to quantify it with precision" (Prepared statement of Sec. Claytor in U.S. Congress, Senate, Committee on Armed Services, Hearings on Proposed Action Under Public Law 85-804 Relating to settlement of Navy Shipbuilding Claims, 95th Cong., 2nd Sess., pp. 68-69).

Claytor further described the claims process as not only imprecise but partisan:

> "What we have done, as is always the case in these situations, we have a partisan Navy group that analyzes the claims and comes up with what they think from our standpoint *** would be fair to offer in settlement, and they include in that their evaluation of some

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* This Ingalls/Litton matter is now in the Claims Court. Proceedings are presently stayed there pending final disposition of the criminal case against Litton.

litigative risks***" (Testimony of Sec. Claytor in id., p. 91)* (See also Sec. Claytor's similar testimony at U.S. Congress, House, Committee on Armed Serviced, Hearings on the Navy Proposal to Modify SSN-688 Contracts with the General Dynamics Corp. (Electric Boat Division) and LHA and DD-963 contracts with Litton Industries, Inc./Litton Systems, Inc. (Ingalls Shipbuilding Division), 95th Congress 2nd Sess., p. 64).

Such statements, and the awards sometimes of hundreds of millions of dollars based upon them, dramatically emphasize the imprecision of the claims process and the difficulty of pinning claims or awards to hard facts.

7. Summary of characteristics: the claims settlement process as bargaining

When the contractor discovers, in the middle of or towards the end of contract performance, that it is going to lose money, it can set out to recoup all or part of that loss through a claim. It hires a sophisticated claims lawyer who:

- o Selects legal theories, each one of which is at least arguably correct;
- o Selects the accounting theories that support the largest claim but still garner at least some professional support; and
- o Relies upon cost estimates, each one of which is generous but at least marginally defensible as a judgment of, largely, delay and disruption costs that are not captured by current record-keeping systems.

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* Secretary Claytor added that:

"Our experience has been *** that in a large number of cases the Board of Contract Appeals and the courts have ended up giving very substantially more than the Navy *** has been willing to pay, so there was great risk to the Navy" (id., p. 92).

The claim, by this time staggering in amount, is submitted to the Navy. The Navy tries to evaluate it in order to determine how much it owes. Partly because of the various pressures to get the matter concluded, partly because the Navy appreciates that the range of the arguably owed amount is so wide, and partly (in some of these instances) because the contractor threatens to stop work unless the claim is settled, the Navy and the contractor end up bargaining over the amount to be paid (whether by a claim award alone or a claim award plus 85-804 relief).

The process that begins as a straightforward claim for payment because of costs due to government actions subsequent to signing the contract, ends as a mid- or late-performance renegotiation of the contract price. The boundaries of the negotiation are set by the loose standards applied to claims and the "ballpark" is defined largely by the size of the claim the contractor has submitted.

Because the amount of the claim is so greatly dependent upon theories and estimates, it is possible for contractors and their attorneys to construct the huge claim that initiates the negotiations by manipulating the theories and the estimates — without making positive misstatements of fact and without concealing what they have done. Indeed, the absence of cost accounting systems that accurately record the additional costs caused by Navy actions during construction to some extent may force reliance on theories and estimates and move the parties toward somewhat arbitrary negotiations.

On the occasion of supporting 85-804 relief to Electric Boat, Jerome Stolarow, Director of GAO's Procurement and Acquisition Division told Congress that:

> "[F]rom an accounting standpoint it is extremely difficult to assign dollar amounts to causes of claims. The causes are interrelated and they are very complex. Accounting records and the types of records that are kept in shipyards just do not lend themselves to very precise identification for each event as to what was the cost and who should be held responsible for it.*** I do not think there is any doubt that — and without assigning motives — the contractors submit the highest possible claims that they can knowing that they are not going to get that much and in every case it is settled at something less" (U.S. Congress, House, Committee on Armed Services, Hearings on the Navy Proposal to Modify SSN-688 Contracts with the General Dynamics Corp. (Electric Boat Division) and LHA and DD-963 Contracts with Litton Industries, Inc./Litton Systems, Inc. (Ingalls Shipubilding Division), 95th Cong., 2nd Sess., p. 158).

> "While the causes [of claims] are known, it is extremely difficult to assess the cost impact of each and to ascertain to what extent the Government and the contractor should each be held responsible.... Given the inability to accurately determine financial responsibility for the cost growth, it forces the parties to negotiate a somewhat arbitrary settlement" (U.S. Congress, Senate, Committee on Armed Services, Hearings on Proposed Action Under Public Law 85-804 Relating to Settlement of Navy Shipbuilding Claims, 95th Cong., 2nd Sess., p. 116).

The nature of the claims process has caused Navy officials to distinguish, albeit for lay discussion instead of legal briefing, between fraud, on the one hand, and, on the other, claiming the highest amount within an arguable range at the outset of an adversarial process that may very likely end with a negotiated settlement. Secretary Claytor told Congress, when defending 85-804 relief to Electric Boat that:

> "[A]ny plaintiff asks for more in his complaint than he expects to get. This is normal. If he pads it with false statements, he goes to jail, but generally speaking, when a judgment factor enters into it, the plaintiff will ask for more than he expects to get, and that is normal (U.S. Congress, House, Committee on Armed Services, Hearings on the Navy Proposal to Modify SSN-688 Contracts with the General Dynamics Corp. (Electric Boat Division) and LHA and DD-963 Contracts with Litton Industries, Inc./Litton Systems, Inc. (Ingalls Shipbuilding Division), 95th Cong., 2nd Sess., p. 63)*

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* Admiral Manganaro, head of the Navy Claims Settlement Board, had the following exchange with representative Stratton over the portion of Electric Boat's $544 million December 1976 claim that the Board had rejected:

> Admiral Managanaro. "They represent the amount of the company's allegations of Government caused delay, disruption, and other elements which the Claim Settelement Board did not consider to be valid."
>
> Mr. Stratton. "They were invalid claims. Now would you say that some of them were phony?"
>
> Admiral Manganaro. "I don't like the word phony. I think some of the claimed items were exaggerated. The company was certainly a strong advocate of its position. My efforts were to evaluate just how much of the $544 million the Government actually owed."
>
> Mr. Stratton. "Well, if somebody calls up on the telephone from Washington, let's say, and has a conversation with somebody at Groton, Conn., and they put down that this was another change order, is that an exaggeration or is that a fraud?"
>
> Admiral Managanaro. "It may be neither. It may be a difference of opinion as to what constitutes a change" (id. pp. 101-102).

III. The Reasons for Declining the Three Closed Cases and What Those Declination Reasons Suggest for Future Cases

A. The Declination Reasons

1. Lockheed

The Lockheed investigation focused principally on (1) the steel portion of Lockheed's claim and (2) the possibility that the claim had sought "total cost recovery."*

a. Steel claim

Lockheed represented that it was forced to buy additional steel for use in the construction of the ships because of defects in the blueprints furnished by the government and waste resulting from government-requested changes. The Navy's referral to the Criminal Division alleged that the claim sought recovery for the cost of steel that Lockheed never used in the construction of the ships.

The Criminal Division declined to prosecute on this theory because the FBI's reconstruction and audit of steel transactions established that the claim included some inaccuracies, but did not connect criminal intent to the inclusion of the undocumented items. Instead, the investigation showed that the inflation was due to faulty records and operating procedures.

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* In the course of the investigation, the FBI uncovered and checked indications of additional wrongdoing. As examples:

The FBI discovered that Lockheed Shipbuilding, in negotiating a contract price for a Coast Guard icebreaker, shifted $400,000 in costs of a contract with the State of Alaska to the cost figure of a previous icebreaker. Coast Guard officials disagreed over whether they used the false figures in arriving at the price of the new icebreaker, and the evidence showed that the costs were shifted not to defraud the government but to hide an overrun on the Alaska ship from Lockheed Shipbuilding's parent company.

The FBI investigated indications that Lockheed might have deliberately falsely certified unqualified welders. However, the evidence was insufficient to warrant prosecution. Conflicting testimony seemed likely if the matter were brought to trial, and further examination of the issue revealed areas of professional disagreement.

b. Total cost recovery

A major part of the investigation focused on the possibility that Lockheed had deliberately constructed its claim so that, if paid, it would recover all of its costs (whether government-caused or not) plus a profit.* The Criminal Division declined prosecution on this theory because the investigation indicated that the Navy had knowledge of Lockheed's claims preparation, was not concerned, may have requested a total claims position, and did not give weight to Lockheed's claims but used them as a negotiating device. In addition, although Lockheed may have appeared to seek total cost recovery on the destroyer contracts, the claim was actually less than Lockheed's total costs in several significant areas, taking into account profit and interest and total ship production costs.**

2. Bath

This investigation examined the potential for criminal fraud in many parts of the arbitrated claim. The Criminal Division declined prosecution because:

(1) most of the allegations boiled down to the fact that the different litigants in the arbitration took different positions, relied on different figures and made different arguments, all of which were either fully aired in the arbitration or litigated there to a point where the arbitrators refused to proceed further; and

(2) many of the disputes centered on technical accounting questions that might have been difficult to explain to a jury; it would have been difficult to prove beyond a reasonable doubt that Bath had selected a particular accounting method with criminal intent.

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* Although the crux of this theory was that Lockheed had backed into its figures, the investigative team did not focus on "total cost recovery" in the technical sense of that term (see pages 20-22).

** Moreover, the head of the claims team, who allegedly was aware of the falsity of the claim, had committed suicide.

Although it would overburden this paper to describe in detail all of the allegations against Bath and reasons for declining prosecution, a few of the facts will illustrate the difficulties in constructing a criminal case. Much of the claim was based upon Bath's contention that the Navy's design agent was late in supplying working plans and that Bath incurred extra expenses because its work was delayed.* Bath contended that a particular schedule — referred to as the Jones Schedule — established the dates on which the design agent should have delivered the plans. At the beginning of the arbitration, Bath argued that the Jones Schedule was the standard for timely delivery of the plans because the dates on the Jones Schedule were the latest dates on which Bath could receive the plans and still build the ships in time to deliver them according to the schedule in the construction contract. During arbitration hearings, one of Bath's own witnesses testified that the Jones Schedule was an accelerated one — i.e., one that included dates for delivery of the plans before the last date on which Bath needed them to meet ship delivery dates. One theory of prosecution was that Bath had deliberately misrepresented the Jones Schedule as unaccelerated.

The Division declined prosecution on this ground largely because Bath itself had brought the accelerated nature of the schedule to the attention of the arbitrators and then taken the position that a claim based upon an accelerated schedule was permissible and that Bath had actually used construction schedules similar to the Jones Schedule. Moreover, the Navy's surrogate in the arbitration* counterclaimed for fraud, on the very ground that Bath had knowingly misrepresented the Jones schedule as being unaccelerated. The arbitration panel explicitly found that Bath had not intended to deceive or mislead. After the hearings closed, Bath made a motion to reopen them in order to require the government's representative to present any additional evidence of fraud so that the matter could be "fully and fairly" adjudicated. The panel denied this request in a written opinion that repeated the finding that Bath had no intent to defraud and stated that the panel believed that the matter had been "fully and fairly" litigated. Thus, the arbitration panel was well aware of the fact that the Jones Schedule was accelerated, had before it all of the relevant schedules, and was satisfied that Bath had not committed fraud.**

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* Bath also claimed that some of the plans were defective.

Other possible grounds for a criminal charge included: (1) Bath's use of "estimated actual" costs instead of the "actual" costs recorded by its accounting system and (2) Bath's contention that certain costs that were fixed were variable or "ran with time." At the arbitration, the Navy's surrogate had in its possession and presented (1) Bath's "actual" figures* and (2) the underlying facts and accounting arguments to support its position that the costs Bath claimed to be variable were in fact fixed. Thus, the facts relevant to deciding Bath's claim were presented to the arbitrators.**

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* Because of the contracting arrangements the Navy made to procure these ships (see p. 11 above), the arbitration was conducted between Bath and Marine Ship Leasing Corporation (MSLC). Since MSLC would charter the tankers to the Navy at a price that would reimburse it for its costs of acquisition, including the amount of any claim awarded to Bath, MSLC was defending the government's interest in the arbitration.

** Although the criminal investigation uncovered evidence not available to MSLC during the arbitration, there were problems proving intent to defraud. Some Bath employees knew that the Jones Schedule was accelerated at the time it was used to construct the claim. However, the evidence was unclear as to when the lawyers who actually prepared the claim (and who eventually presented the testimony revealing the truth) had that knowledge.

3. Electric Boat

The criminal investigation focused on two parts of the claim: (1) unsuitable data and (2) delay.***

a. Unsuitable data

Electric Boat contended that 89 "data items" among the detailed working plans supplied by Newport News (lead yard and design agent for the SSN 688 submarines) were "unsuitable" because they called for unnecessarily complex and uneconomical methods of construction. The claim sought recovery of the added costs that were occasioned by the unsuitability and that were unanticipated at the time Electric Boat bid for and signed the contract for the second series of SSN 688s (Flight II).

The Navy analysis of the December 1976 claim found that, at the time of the Flight II bid and closing, Electric Boat had in its possession many of the detailed working plans later claimed to be unsuitable. Electric Boat had already used many of these plans in its work on the first series of SSN 688s (Flight I). This suggested that Electric Boat falsely stated in the claim that the costs resulting from unsuitability were not anticipated at the time of the bid and closing.

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* Bath contended at the arbitration that the "actuals" did not capture disruption costs.

** In addition, both the leader of Bath's claim team and the expert employed by MSLC during the arbitration had died by the time the Criminal Division made the decision on a possible indictment.

*** The investigators also examined the possibility that some of the costs Electric Boat claimed it had incurred in attempts to "mitigate the delay" caused by government actions were fraudulent in that the company had intended to incur those expenses anyway. The investigation, however, never developed sufficient evidence for the Division seriously to consider prosecuting on this theory.

The Criminal Division declined prosecution on this theory because Electric Boat had carefully specified in its claim that the knowledge attributed to it for purposes of determining the unsuitability that was anticipated at the time of the Flight II bid submission was limited to the knowledge of those particular persons who prepared the estimates for the bid. Electric Boat could argue that these estimators were unaware of the unsuitability already spotted by the production staff.*

A second theory for prosecuting on the unsuitable data portion of the claim built upon Electric Boat's concession that it should have excluded from the claim the unsuitable data items discussed in trip reports and Liaison Action Reports (LARS) written before the Flight II bid. The Division considered prosecuting on the theory that the company had deliberately included data items covered by the LARS. Although one expert working with the investigation believed that some of the data items were LARS-related, the Division declined prosecution because the government probably could not prove this critical fact beyond a reasonable doubt. Instead, this issue promised to be a battle of the experts at trial.

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* In addition, there was some evidence that the Navy had urged Electric Boat to lower its Flight II bid, because the Navy believed it was too high. This fact undercut the argument that Electric Boat had deliberately submitted a bid that it knew was too low to take account of the unsuitability for which it later claimed.

b. Delay

At the time it filed the December 1976 claim, Electric Boat was estimating that the Flight II submarines could not be delivered according to either the schedule contained in the 1973 contract or the 1976 modification to that schedule. Electric Boat contended that the government was responsible for all of the costs that it would incur as the result of delays in production, even though Electric Boat had experienced problems, such as low productivity of its work force and poor management, that logically must have slowed production.

The Division declined prosecution because it concluded that the question of who caused or was responsible for the costs associated with delay was as much a question of legal theory as of fact. Electric Boat could contend that its statement that "[t]he delays incorporated in this delivery schedule are due entirely to Government responsible events" was largely a legal conclusion. Electric Boat could base its argument on the theory that the government (largely through its design agent) was responsible for all of the delay-caused costs because it was the predominating cause of delay. Electric Boat could argue that, in its judgment, it could have met its schedule absent government actions. It could contend that, since the government had undoubtedly taken actions contributing to the delay and since it was impossible to separate out particular portions of the delay attributable to thousands of government actions interacting with thousands of Electric Boat actions, Electric Boat was entitled to rely on that judgment and assert that the government was legally responsible for the entire delay. The government would have disputed this in litigation before the ASBCA or Court of Claims. The Criminal Division, however, concluded that Electric Boat had not committed a crime by openly advocating this position in circumstances where the Navy was familiar with the underlying facts that allowed it to evaluate and dispute Electric Boat's position.

c. Lack of intent

In addition to the reasons relating to particular theories, the Division declined to prosecute Electric Boat for the more general reason that there was no direct evidence of criminal intent. The investigation failed to unearth any insider testimony or "hot" document providing direct evidence of a purpose to cheat the government.

d. 85-804 relief

Finally, the Division concluded that any prosecution would be damaged by statements made by Navy officials at Congressional hearings where they defended the Electric Boat 85-804 relief. These Navy statements are quoted above at pages 22-23.

With these statements on the record, the Justice Department would have had to convince a jury that Electric Boat should be convicted as a criminal based on mistakes it had made in a process that the Navy admitted to be partisan, necessarily imprecise, and unfair in the sense that it would not award Electric Boat everything it deserved. The Department would have been seeking a conviction, based (or so Electric Boat could argue) on disagreements over theories, after Navy statements had highlighted the distinction between fraud and differences in judgment.*

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* During hearings on the 85-804 relief, the Navy had assured Congress that the proposed contract modification would not impair the government's ability to pursue civil and criminal fraud remedies (U.S. Congress, House, Committee on Armed Services, Hearings on the Navy Proposal to Modify SSN-688 Contracts with the General Dynamics Corp. (Electric Boat Division) and LHA and DD-963 Contracts with Litton Industries, Inc./Litton Systems, Inc. (Ingalls Shipbuilding Division), 95th Cong., 2nd Sess., pp. 65-68, 75, 97). In a letter to the Chairman of the House Armed Services Committee, the Assistant Attorney General for the Civil Division had said:

(Footnote continued on the next page.)

B. The Reasons For Declination Are Related to Characteristics of the Claims Process

The Criminal Division declined to prosecute Lockheed, Bath, and Electric Boat because lengthy and thorough investigations revealed insufficient evidence of criminal violations. To some extent, the investigations were hampered by problems often encountered in complex investigations. Thus, because years had elapsed since the construction of the ships and the preparation of the claims, memories of witnesses had faded and, in a few instances, key individuals had died (e.g., the leaders of the Lockheed and Bath claims teams). Moreover, the division of responsibility within each shipyard made it difficult to identify employees who had complete knowledge of the questionable parts of the claims, and who could be held accountable for their accuracy. Electric Boat capitalized on this division of responsibility when it argued that only the information available to the estimators of the Flight II bid should be considered in determining what unsuitable data items were unanticipated at the time of the bid, and that the knowledge of the yard workers who had worked with those plans on Flight I construction should be ignored. Finally, several prosecution theories (e.g., that Electric Boat's claim for unsuitable data

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(Footnote continued from previous page)

> "I am advised by the Criminal Division that there are pending criminal fraud investigations relating to the contract claims made by General Dynamics Corporation. The Criminal Division has stated that the proposed contract modification may have some slight effect on these investigations, but they are not opposed to the modification" (quoted at id., p.69).

It is safe to say that, at the time, the Criminal Division did not know what statements government officials were going to make about the claims process and the Electric Boat claim in the course of defending the 85-804 proposal.

related to matters discussed in IARS) were complicated by technical and accounting issues. The government would have had difficulty explaining these issues to a lay jury and proving the facts about them beyond a reasonable doubt.

More important than these problems, however, were the fundamental problems created by the nature of the claims process itself. A criminal prosecution for a false claim, false statement, or conspiracy to defraud the government generally assumes that the defendant has deliberately made false statements of fact or otherwise employed deceitful or dishonest means against the government. The declinations in these matters can be traced largely to the difference between the premises of a criminal prosecution and the realities of the Navy claims process, as described by the characteristics set out at pages 16-26 above.

The partisan nature of the claims process, the expectation that parties will take extreme negotiating positions, and the provision of 85-804 relief in a manner acknowledging that the claims process may not adequately address the "merits" of a claim because of the necessary imprecision in relating government changes to delay and disruption costs were factors directly related to the Division's decision declining Electric Boat. The Navy's view of Lockheed's claims as a negotiating stance similarly influenced the Division's declination in that matter.

The range of allowable arguments figured into the Electric Boat declination. The declination on the unsuitable data issue resulted largely from the contractor's openly advanced theory of limited imputed knowledge and the declination on the delay issue resulted largely from the belief that Electric Boat could contend that its statement of government responsibility was largely a legal contention rather than a deliberate misstatement of fact.

The mistakes that Lockheed made in computing its steel claim and Bath's use of "estimated actuals" instead of "actuals" resulted from the absence of accepted accounting and proof techniques for use in claims.

The openness of the system to total cost claims (or similar claims prepared by backing into final numbers) -- indeed, the possible solicitation of such claims — was one of the facts directly responsible for declining the total cost theory of fraud in Lockheed.

IV. Management of the Investigations

This section describes some of the management difficulties encountered in the Lockheed, Bath, and Electric Boat investigations. These investigations, handled in a highly charged political atmosphere, posed substantial problems for the Fraud Section of the Criminal Division. Moreover, the Bath and Electric Boat referrals arrived at roughly the same time as the Newport News referral. At the outset of these investigations, the Fraud Section had little conception of how large these investigations would be, and the unprecedented size and complexity of these investigations were in part responsible for the management problems. Since the Fraud Section did not realize how large and unwieldy these investigations would become or how difficult proof of criminality would be, given the nature of the Navy claims process, the Section did not then anticipate the importance of imposing tight management on these undertakings.* We are not suggesting that the ultimate outcomes of these cases would have been different if there had been tighter management controls. Nonetheless, the experience gained from these investigations may help improve the management of future cases.

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* The discussion below focuses on shipbuilding claims investigations simply because they are the subject of this paper. The recommendations for tighter management of similar investigations in the future should in no way be construed as implying that management is unnecessary in other, smaller investigations. Every investigation should be subject to management controls.

A. Supervision

Although all of these investigations were supervised, the Fraud Section did not direct concentrated management attention to them until an indictment review committee meeting* or when some problem arose (e.g., when disagreements between the attorneys and agents prompted requests for summaries of evidence). The indictment review committee meetings were the only extensive formal reviews, and those were conducted long after the investigations were underway (about 32 months after the referral and 22 months after the first FBI agent was assigned in Bath; about 29 months after the referral and 24 months after the first FBI agent was assigned in Electric Boat). As far as we could determine, there were no attempts by management to establish schedules with built-in full dress reports on progress before the indictment reviews occurred.**

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* The suggestions for earlier and tighter management in this paper are not a criticism of indictment review committees, which examine a case when the line attorney believes the investigation has reached a point where he or she can make a recommendation to prosecute or not. The purpose those committees serve is to look at a case afresh and to spot the problems that the attorneys — both on the line and in supervisory positions — may have missed. The point is only that this fresh look, which necessarily is best taken after the investigation is far along, cannot substitute for earlier, plenary review by a supervisor and/or some group of experienced Fraud Section attorneys.

** The supervisory practices identified in these shipbuilding cases were the same as those applied to all Fraud Section cases. Current section leadership has made major changes in the management and supervision of investigations.

Earlier active supervision of similar investigations could yield several benefits. First, it could reduce the chance that investigative resources will be devoted to gathering facts to support a theory of prosecution that supervisors will ultimately reject.* This was a particular problem with the Electric Boat investigation, in which the agents and the line attorney devoted a great deal of time collecting facts to support theories relating to the unsuitable data and delay portions of the claim. The supervisors rejected these in the end largely because of the language of the claim and its possible interpretation by the defense. The language of the claim was known at the outset of the investigation and close supervision at that time might have focused attention on the problems that ultimately led to the declination.**

Second, although a criminal investigation of an enormous claim cannot be run on a strict schedule, and must allow the investigators and line attorneys to follow leads that they uncover, closer supervision might move the investigative work along by focusing efforts on the most crucial issues and by establishing schedules or checkpoints.*** These investigations (and the reviews of them) continued for several years (Lockheed: four years and nine months; Bath: four years; Electric Boat: three years and ten months).

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* Such experiences strain relations between the prosecutors and investigators.

** Early supervision would not necessarily have terminated investigative work on these theories. For example, even though the claim was written to restrict the knowledge of unsuitability imputed to the corporation to the knowledge of those preparing the bid estimates, this still left open the questions of which employees and officers were involved in preparing the estimates and what knowledge of unsuitability they had.

*** There is no way to know for sure whether closer supervision would have brought the Lockheed, Bath, and Electric Boat investigations to a more timely end, in part because the publicity and congressional interest accorded to particularly the Lockheed and Electric Boat matters. However, Fraud Section management is in a much better position than the line attorney to draw the line and cut losses on an unproductive investigation under those circumstances.

Finally, closer supervision might bring the experience and wisdom of the supervisors to bear on the questions of investigation staffing and relations with the Navy both during an investigation and at its conclusion. This report discusses these subjects separately below, but, given the variety of circumstances that can arise in a claims case investigation, this report will not offer pat formulas. Supervisors must address these topics separately in each case.

Better supervision may be particularly difficult in investigations conducted jointly by the Fraud Section and USAOs. Either the Section or the USAO should have principal responsibility for supervision so that the attorneys and investigators receive one consistent set of directions. The Fraud Section may be in a better position to lead such an investigation than the USAO because a shipyard may have economic power within a district that would complicate U.S. Attorney decisions and because the recently established Defense Procurement Fraud Unit within that Section will be able to use its special expertise and well-developed relations with Department of Defense investigative agencies to coordinate and direct an investigation more effectively.

B. Attorney and Agent Staffing

1. Experience in large paper cases

A claims investigation typically involves an enormous number of documents. Some members of the investigative teams in these cases lacked extensive experience in large paper cases. For example, the agents estimate that at one time Bath produced thousands of poorly labeled transfer boxes of paper, only some of which related to the tanker contracts under investigation. The agents, however, had had little experience in cases involving such massive amounts of paper.

2. Attorney and agent turnover

The Bath investigation and, at least at the outset, the Electric Boat investigation experienced some attorney turnover.* The Fraud Section first assigned both cases (plus Newport News) to an attorney who tried to establish teams from the Navy, USAOs and the Section. After the USAO in Maine requested that the Fraud Section handle the Bath investigation, responsibility was transferred first to one line attorney, then to a second (who began the first significant attorney work in January 1979), then to a third line attorney who began full-time work on it in the summer of 1980 (a year and nine months after the FBI had assigned agents to work on the investigation).

The Electric Boat matter was also first assigned to the Fraud Section attorney who was to coordinate establishment of USAO-Navy-Section teams for that matter and the Bath and Newport News matters. This attempt foundered in the Electric Boat investigation because both the Fraud Section line attorney assigned to the case and the Assistant U.S. Attorney from Connecticut moved on to other jobs. Then, after the FBI had been working on the case for about ten months, the Fraud Section assigned the line attorney who ultimately performed most of the work on the case.

This study did not examine the Newport News and Litton investigations in depth. It appears, however, that those cases may have suffered attorney turnover problems even more severe than those in Bath and Electric Boat and that the turnover problems in those cases may have been caused in part by a lack of coordination between the Fraud Section and the U.S. Attorney's Office in Alexandria.

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* The Lockheed investigation did not.

Attorney turnover is a potential problem in any investigation, and it may not always be avoidable.* The complexity of the shipbuilding investigations and the large volume of documents in them mean that turnover in these investigations can be particularly damaging.

Although agent turnover was not as great a problem as attorney turnover in these investigations, the complexity of the cases suggests the need for close examination of tactics such as those employed in the Bath matter. At one point in that investigation, a large number of agents who had no previous involvement with the investigation were brought in for an interviewing blitz. The advantages to be gained from roughly simultaneous interviews must, in these cases, be balanced against the possibility that even the best agents, brought into a complicated investigation with massive amounts of documents, may find it difficult to ask follow-up questions in the interviews they conduct.

3. Numbers of attorneys and exclusive attorney assignments

In the Lockheed matter and (until the summer of 1980) in the Bath matter, the attorneys assigned to the investigations had other active cases and matters and, although they visited, were not spending the bulk of their time at the site where the agents were examining the documents. In the Electric Boat investigation, (after May 1979), the attorney worked on the matter full-time and on-site. During the period that a second Fraud Section attorney worked on Electric Boat full-time, the speed of the grand jury proceedings in that investigation roughly doubled.

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* Neither the Fraud Section nor a USAO can know for how long a particular attorney will stay in his job or for how long a given investigation will last. Moreover, there are instances such as the Bath investigation where management decides that a transfer of line attorney leadership is desirable because of differences in style between agents and attorneys.

In retrospect, a full-time, on-site attorney might have moved the Bath investigation forward by providing more direction to it and improving the coordination between attorney and agents. In the Lockheed case, however, an attorney's daily presence might not have helped, particularly during the time that agents were reconstructing and auditing the steel transactions in Seattle.

C. Relations with the Navy

The relationship between the investigative team and the Navy is important to a particular investigation because the Navy may be able to provide valuable assistance in understanding a claim. The relationship is important beyond the particular case because Justice needs both to encourage the Navy to refer matters that will make good criminal cases and to discourage the Navy from referring matters that will not.

1. Using the Navy's expertise

The Division tapped the Navy's expertise during these investigations in various ways. The FBI and the Division obtained some assistance from the Navy's Supervisor of Shipbuilding (SUPSHIP)* in Seattle during the Lockheed investigation. The Electric Boat investigation team included two technical consultants on contract with the Navy as well as part-time technical assistance from the SUPSHIP in Groton, one of the offices involved in analyzing the Electric Boat claim. A Military Sealift Command attorney who had been involved in writing the Bath contracts and supervising the arbitration of Bath's claims worked with the investigators and the attorneys during the Bath investigation, and a Naval Audit Service auditor devoted at least some time to the case.

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* The SUPSHIP offices, located at the main shipyards that build Navy ships or in central locations, were established for field contract administration. The SUPSHIP, as the administrative contracting officer, is in daily contact with the shipbuilders concerning business and technical administration of the contracts. The most visible role of a SUPSHIP is that of observer and inspector of the shipbuilders. SUPSHIP offices participate in Navy claims evaluation (1978 Naval Ship Procurement Study, p. 194).

Interviewees differed on whether the investigations used Navy expertise either fully or promptly and on whether, to the extent there were problems, they originated in the Criminal Division's failure to seek help or the Navy's failure to provide it when asked. Although it is clear that Navy assistance is needed in these cases, there is no consensus on how a criminal investigation team should be staffed to use that assistance best.

2. Using the investigations to encourage referrals that will make good criminal prosecutions and discourage those that will not

At the close of each of the three investigations, the Criminal Division sent a brief letter to the Navy General Counsel summarizing the reasons for declining to seek indictment. In addition, the Military Sealift Command attorney involved in the Bath investigation participated in the Fraud Section's indictment review committee meeting on that matter and in discussions with a Fraud Section supervisor after that meeting but before the Division had declined to proceed.

Despite these efforts to communicate, parts of the Navy still believe that some of the matters that Justice declined would have made good criminal cases. More importantly, there is no indication that the experience from these cases would help the Navy decide whether a new claims matter should be referred to the Criminal Division or how a referral should be drafted.

D. Civil Remedies

The Lockheed, Bath, and Electric Boat matters were all referred to the Civil Division. The Civil Division did not institute suit on any of these cases (a $2 million suit is still under consideration against Electric Boat), largely because the evidence would not establish causation and damages (i.e., payment by the government traceable to the fraudulent part of the claim). These proof problems may be eliminated in the future by application of the fraud provision in the Contract Disputes Act.*

There was not, at the time these cases were referred to the Criminal Division, any established procedure for keeping the Civil Division apprised of the cases or discussing what role civil sanctions should play. The new Defense Procurement Fraud Unit, which includes a Civil Division attorney, may address this concern to some extent.

V. Application of Lessons Learned from the Claims Cases

A. Navy Actions Taken to Prevent Claims

Over the course of many years, the Navy has reviewed the growing problem of claims** and has taken numerous steps to avoid or reduce them. These have included changing acquisition practices and contract clauses to shift additional risk to the government; instituting contract administration procedures to minimize constructive changes; and regulating the submission of claims and the claims review process.

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* "If a contractor is unable to support any part of his claim and it is determined that such inability is attributable to misrepresentation of fact or fraud on the part of the contractor, he shall be liable to the Government for an amount equal to such unsupported part of the claim in addition to all costs to the Government attributable to the cost of reviewing said part of his claim. Liability under this [section] shall be determined within six years of the commission of such misrepresentation of fact or fraud" (41 U.S.C. 604).

** For example, the 1978 Naval Ship Procurement Process Study, cited extensively in this report, was undertaken to review Navy Ship acquisition policies and recommend changes to minimize future claims. The report's conclusions and recommendations were reviewed by a NAVSEA group and then by the Ship Acquisition Policy Council made up of NAVMAT, the Office of General Counsel and the Assistant Secretary of the Navy (Manpower, Reserve Affairs, and Logistics). NAVSEA prepared and promulgated a Ship Acquisition Policy Manual to document recommended procedures for reducing claims.

Changes in contracting practices have shifted more of the risk away from the contractor. Lead ships are now generally procured through cost-reimbursement contracts where the ships are the first of a newly designed class involving a high degree of developmental or cost risk. Follow ships are still generally procured through fixed-price incentive contracts, but the range within which the government shares amounts over target costs has increased. The Navy has also liberalized escalation clauses, and has added special clauses shifting increased fringe benefits and energy costs to the government. The effect of these changes is to reimburse contractors for unanticipated costs without requiring a claim.

The Navy has also taken measures to address the problem of constructive changes. It has trained its engineers and technicians to improve the quality of Navy-furnished specifications, and has required drawings to be validated. It has trained Navy personnel dealing with shipbuilders to avoid actions that a contractor could construe as constructive changes.

In an effort to regulate claims submissions the Navy began, in the 1970s, to include anti-claims "clauses" in its ship acquisition contracts. Today, new contracts require shipbuilders periodically to release their rights to assert claims based upon constructive changes. Thus, at time X, the contractor releases rights to claim for constructive changes based upon government actions during the period from time A to time B, at time Y it releases rights to claim for constructive changes based upon actions in the period from time B to time C, and so forth.

These Navy actions decrease the probability that the Navy will refer major shipbuilding claims matters to the Justice Department in the future. At present no large omnibus claims are pending in the Navy.

If a new omnibus claim were submitted to and reviewed by the Navy, it might still have some of the characteristics that made prosecution difficult in the Lockheed, Bath, and Electric Boat cases.* Although the law has been changed to increase claim certification requirements,** a contractor might still back into negotiating positions by advancing creative theories and relying on estimates that fall at the end of the range that favors the contractor's position. These problems would decrease if the range of permissible claim advocacy were narrowed, e.g., by establishing standards for claims submission. The Navy, however, must judge the feasibility of such steps, as well as their desirability in light of the role claims play in Navy ship acquisition. The choices the Navy makes in the way it manages claims will affect the ability of the criminal justice system to police the claims process.

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* The fraud provision of the Contract Disputes Act (p. 45 above) was enacted

> " out of concern that the submission of baseless claims contribute to the so-called horsetrading theory where an amount beyond that which can be legitimately claimed is submitted merely as a negotiating tactic" (Sen. Rept. 95-1118, quoted at 5 U.S. Code Cong. and Admin. News (1978), p. 5254).

However, since that section applies only where the contractor has inflated its claim by a misrepresentation of fact or fraud (41 U.S.C. 604; and see 41 U.S.C. 601(7)), it may have only a limited impact on shipbuilding claims. As set out above (pp. 23-26), the size of shipbuilder claims depends largely upon legal and accounting theories and cost estimates, particularly as applied to delay and disruption portions of the claims. Contractors can place themselves in a favorable negotiating position by manipulating these theories and estimates without making the misrepresentations of fact or committing the fraud that would subject them to the sanctions of the Contract Disputes Act.

** The Contract Disputes Act provides that:

> "For claims of more than $50,000, the contractor shall certify that the claim is made in good faith, that the supporting data are accurate and complete to the best of

(Footnote continued on the next page.)

B. Recommendations for Criminal Prosecution of Claims Cases

The experience gained in the Lockheed, Bath, and Electric Boat matters suggest principles that may help the Department determine whether it should pursue any given claims-related criminal referrals in the future.

1. A criminal investigation should, early on, consider whether actions taken in the claims process argue against prosecution

The experience of these investigations suggests that the Justice Department should at the outset consider whether Navy actions during the claims process will affect the Department's ability to construct a prosecutable case. Such consideration should include an inquiry into whether the Navy knew that alleged misrepresentations were untrue, whether the particular representations that will be investigated were taken

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(Footnote continued from previous page.)

> his knowledge and belief, and that the amount requested accurately reflects the contract adjustment for which the contractor believes the government is liable" (41 U.S.C. 605 (c)(1)).

Section 813 of the Department of Defense Appropriation Authorization Act, 1979 (P.L. 95-485, 92 Stat. 1611) provided that:

> "Notwithstanding any other provision of law, none of the funds appropriated for the Department of Defense by this or any other Act shall be used for the purpose of paying any contract claim, request for equitable adjustment to contract terms, request for relief under Public Law 85-804, or other similar request, which exceeds $100,000 unless a senior company official in charge at the plant or location at the time of submission of such contract claim, request for equitable adjustment to contract terms, request for relief under Public Law 85-804, or other similar request, that such claim or request is made in good faith and that the supporting data are accurate and complete to the best of such officials knowledge and belief."

The Contract Disputes Act applies to contracts entered into 120 days after its enactment on November 1, 1978, and to earlier contracts if the contractor elects to proceed under that Act. Section 813 of P.L. 95-485 applies to claims, requests for equitable adjustment, requests for 85-804 relief, and similar requests submitted after its enactment on October 20, 1978.

seriously by the Navy, and whether the Navy might have invited them. The investigators should review Navy statements made in connection with 85-804 relief to determine whether they will undercut possible prosecution.

2. A criminal investigation should not be a second claims analysis

The criminal investigation should not attempt to duplicate the administrative evaluation of the validity of the claim. The criminal justice system does not have the resources to undertake such a task. Moreover, the engineering and accounting questions on which such an analysis will focus (e.g., the use of "actuals" vs. "estimated actuals" in the Bath matter) frustrate proof of fraud beyond a reasonable doubt, absent some more traditional evidence of intent such as insider testimony or altered, false, or destroyed documents.

The criminal investigation generally should not focus on theories of entitlement. The criminal justice system does not directly address the question of whether a theory of recovery (or method of proof) is valid for the purpose of paying money on a claim. Instead, the criminal justice system addresses the very different question of whether it is a crime to advocate the theory (or employ the method). Since it is generally not a fraud to advance most farfetched or even silly theories, the Criminal Division has concluded that criminal investigations based upon theories of recovery (e.g., the limitation of knowledge of unsuitability in the Electric Boat claim) are unlikely to succeed.

3. A criminal investigation is appropriate where there is an indication that the administrative process for analyzing a claim was corrupted

The proper role of a criminal prosecution in the claims area is to punish those who have tried to corrupt the administrative analysis of the claim. The corruption might take many forms. It might involve bribery of the officials reviewing a claim, or the corruption might consist of deliberate misrepresentations of facts. Deliberate misrepresentations that form the basis of good criminal cases are often accomplished through such actions as:

- alteration of records;
- destruction of records;
- failure to keep records that a legitimate business would keep;
- creation of phony back-dated records;
- signals by management to the employees preparing the claim that they should include false statements; and
- secret conspiratorial meetings at which company executives decide to submit false statements of fact.*

In the best criminal case, the same individual will both know that a particular statement has been included in a claim and know that it is false. If the criminal case is a good one, the targets will frequently try to interfere with the investigation itself.

In deciding whether to refer a matter, the Navy should examine the facts to see whether any of these indicia of criminality are present or whether there is a realistic chance of uncovering evidence of them if the investigation proceeds. Similarly, the Department will want to determine, soon after receiving a referral, whether there is a realistic hope of finding such evidence or otherwise constructing a good criminal case, given the nature of the claims process.*

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* A recent successful claims prosecution points the way. In U.S. v. Phillip W. Akwa, et al. No. 82-8-ORL-CR-R (U.S.D.C.M.D.Fla.), the prosecution focused on very particular misrepresentations of fact. The prosecution rested on misstatements, in a claim submitted to NASA, of such facts as the number of hours worked by particular employees. The government was able to prove that the contractor's estimate of those hours was deliberately false because it was at odds with several different kinds of records the contractor maintained, and that some time cards had been altered in an attempt to support some parts of the claim. The Akwa case is particularly interesting because the defendants contended they had submitted their figures as part of a negotiation and that they could not be convicted for "puffing" those figures. The conviction in that case is on appeal and may produce a Court of Appeals decision addressing the impact on criminal fraud prosecutions of "negotiations" in claims proceedings.

The recently formed Defense Procurement Fraud Unit, because of the way it is structured, should be able to learn of future claims cases earlier and screen the cases effectively to determine whether they have criminal potential. This special investigative and prosecutive unit was established last year to concentrate on fraud and corruption in defense procurement. The unit will itself conduct nationally significant investigations and prosecutions of matters that seriously compromise the integrity of the defense procurement process. It will also monitor Defense Department referrals to the Department of Justice as a whole, and thus be able to detect patterns of fraud against the procurement process. In addition, the unit will provide technical assistance and guidance to U.S. Attorneys' Offices handling defense procurement cases.

The staff of the unit presently includes experienced attorneys from the Criminal Division, the U.S. Attorney's Office in Eastern District of Virginia, and the Civil Division. Several attorneys are now detailed from the Department of Defense to provide procurement expertise and additional prosecutive resources. The unit is structured so that it can draw on the expertise and manpower of the FBI and of all relevant investigative and audit agencies of the Department of Defense.

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* While it could be argued that this approach misses the "big picture" fraud, those who advance this point of view are at bottom complaining about the very characteristics of the Navy claims process that make fraud prosecutions difficult.

C. Recommendations for Management Improvement

The Criminal Division or the U.S. Attorney's Office should utilize management review procedures to screen claims matters when they are referred and to monitor their progress if they are pursued. The initial screening should take into account the principles set out in section V.B above. If the Department decides to pursue an investigation, top-level management should approve an investigation plan.* The plan should address the questions of attorney and agent staffing, how Navy expertise can best be used, and what the focus of inquiry should be.

The plan should include a timetable that, among other things, specifies times at which management will review the investigation to consider whether it should continue, and, if so, whether the staffing or focus should be changed. The timetable could specify these times by setting dates or by identifying certain steps in the investigation after which the committee will meet. To the extent possible, management should try to define at each review what factual or legal research questions the line attorneys should address before the next review. If the goals are not met, management should explicitly consider dropping the case.

Based on the Department's experience in past shipbuilding claims investigations there should be, to the extent possible, a core of attorneys and investigators assigned for the duration of a claims investigation, and the attorneys and agents should have experience in large document cases. The DOD Procurement Fraud Unit, with its experienced attorneys and investigators, as well as its pool of technical experts, could effectively staff such a case in the future.

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* The Fraud Section of the Criminal Division has already imposed this requirement on line attorneys and supervisors handling significant cases. However, if the Navy referred another claims-related matter of the size of Electric Boat or Newport News, the Section might very well create a special body to monitor it, including the Section Chief, the supervisor of the line attorney(s) handling the matter and, perhaps, one or more other attorneys experienced in government fraud. Just as the Navy would concede that another claim of the magnitude of the Electric Boat claim would require the Navy to create special bodies, procedures, and management structures to evaluate it, so the Fraud Section would likely have to modify its procedures to manage an investigation of such an enormous claim effectively.

At the outset of a claims investigation, the Department should consider whether at least the lead attorney and lead investigator assigned to these matters should have previous experience in investigations involving large volumes of documents. They may need such expertise both to maintain the spirit to hunt through the mountain of paper and, more importantly, to find and focus their efforts on those documents relevant to particular allegations with criminal potential.

There can be no set rule on the number of attorneys assigned to a claims investigation, the proportion of their time devoted to it, or whether they spend their time on-site where the contractor is producing documents. Similarly, there is no pat formula for using the Navy's expertise during a claims investigation. These matters should, however, be considered at the outset of such an investigation and periodically reconsidered as it proceeds. Managers in the Criminal Division or U.S. Attorney's Office may have to decide these questions because of the large resource commitment that may be necessary to pursue such investigations effectively.

If an investigation terminates without indictment, management should carefully explain to the relevant parts of the Navy why it sought no indictment and make recommendations for future referrals.

D. Consideration of Legislative Change

Imprisonment of individuals, particularly those supervising claims preparation, probably would be an effective deterrent to claims crimes. The complexity of shipbuilding firms and the division of labor within them, however, can frustrate the indictment of individuals. For this reason, the Electric Boat investigation concluded with a review centered upon possible indictment of the corporation, not individual employees. Similarly, only the corporation was indicted in the Litton case. The Division should directly confront the question of whether a prosecution is worthwhile if only a corporation can be indicted, or whether legislative changes should be proposed to make sanctions against corporations more effective. Since a corporation cannot be imprisoned, a fine is the only direct punishment following on conviction. The fine may be in an amount that is insignificant in relation to the amount of the claim. As an example, the claim filed by Electric Boat in December 1976 sought about $544 million in contract price adjustments. Even if the company could have been indicted on 90 violations of 18 U.S.C. 287, the maximum fine would have been $900,000 — less than one quarter of one percent of the claim. A related civil case following a criminal prosecution would (if won) have recovered a much larger amount. However, in a case such as Electric Boat, where the government has not only paid what it believes it owes on the claim but has also provided $359 million of relief under 85-804, the large civil recovery would simply place back in the government's pocket part or all of the amount it had paid out because the contractor was suffering losses judged to be inimical to the national interest.* If a criminal conviction led to private securities lawsuits, they too might eat into the very relief provided through 85-804.**

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* Moreover, some of the collateral sanctions of criminal conviction may be unavailable here. For example, unless the government were to take over the yards, debarment is not a real option where only eleven private shipyards contract for Navy work and even fewer are capable of producing particular types of warships.

** Nothing in this point argues against an investigation of possible criminal conduct in the granting of the 85-804 relief, which could conceivably involve fraud, conflict of interest, or bribery.

This is not to argue that the Division should shy away from an indictment of a shipbuilding corporation. If an investigation produces evidence of an offense, there are strong arguments that weigh in favor of indictment, and public opprobrium and possible congressional criticism following a fraud conviction may impose significant punishment even if monetary punishment is not desirable. However, the Division should consider the question of what sanctions are available and whether legislation embodying additional sanctions (e.g., removal of a contractor's managers from their jobs) should be proposed.

E. Application Beyond Navy Claims

Other departments have claims procedures similar in at least some respects to Navy procedures. For example, the Akwa case (p. 50 above) grew out of the NASA claims procedures. The lessons learned from the Navy claims investigations may be applicable to claims-related matters from these other departments. Some of the management lessons may have even wider application to extended, document-heavy investigations generally.

APPENDIX A

List of Interviewees

Fraud Section, Criminal Division

Ann Arbor
Joseph Covington
James Graham
Jo Ann Harris (former Chief)
Ihor Kotlarchuck
Donald McCaffrey
Robert Ogren (Chief)
Richard Sauber

Deputy Assistant Attorneys General, Criminal Division

Mark Richard (former Chief, Fraud Section)
Roger Olsen

Commercial Litigation Branch, Civil Division

Robert Ashbaugh
Dennis Egan
Jane Restani - Director

FBI

Richard Denton - Headquarters
Robert Fuhriman - Seattle
William Imfeld - New Haven
Thomas McDaniel - Providence
Donald Ramsey - Seattle

Navy

Lars Anderson - Attorney, Military Sealift Command
Eugene Angrist - Counsel, Naval Sea Systems Command (NAVSEA)
Paul Clark - Naval Investigative Service Agent
Tim Foster - NAVSEA08 (Rickover's former staff)
Joan Gottfried - Associate Counsel, NAVSEA
Robert Murphy - NAVSEA08 (Rickover's former staff)
Eugene Paulisch - Litigation Division, Office of General Counsel
Richard Sherman - Associated Counsel, NAVSEA
Harvey Wilcox - Principal Deputy General Counsel

Other

Willard Blaney - participant in the Navy's technical evaluation of Litton and Newport News claims and technical advisor to Justice Department's Electric Boat investigation team
John Cassidy - Miller, Cassidy, Larocca & Lewin
Robert Gusman - Lockheed
Martin Minsker - Miller, Cassidy, Larocca & Lewin
Patricia Szervo - counsel, Office of Federal Procurement Policy, former attorney, Navy Office of General Counsel

APPENDIX B

Detailed Description of Claims and Processing of Claims in Lockheed, Bath, and Electric Boat

Lockheed

In 1964, Lockheed was awarded a $60 million fixed-price contract (with an escalation provision) for five destroyer escorts. The contract was modified in 1965, extending for five months the delivery dates for each vessel because of late delivery of government furnished equipment (sonar). Subsequent modifications in 1967 and 1970 extended the delivery dates further, but reserved the parties' rights as to respective responsibilities for that additional delay.

The three fixed-price contracts (with escalation clauses) for amphibious transport dock vessels (LPDs) were awarded to Lockheed in 1963, 1964 and 1965 for $50 million (two vessels), $70 million (three vessels), and $48 million (two vessels) respectively. All of the original contract dates were amended in 1970, but the parties did not agree at that time upon an apportionment of respective responsibilities for the delay.

In November 1968 and early 1969, Lockheed submitted its first consolidated claim concerning all four contracts, which was revised several times thereafter (until the spring of 1971). At one point, the amounts claimed totaled about $160 million.

Generally, the claims were based on defective Navy furnished plans and specifications and late or unsuitable delivery of government furnished property and data, which led to extra work, delay, and disruption. For example, the Navy rejected Lockheed's plan to substitute butterfly valves for gate and glove valves on one of the LPD contracts, even though the ship specifications indicated that such substitutions were acceptable. Lockheed alleged that the impact of the change was substantial. Lockheed had already ordered the lighter butterfly valves, and production schedules reflected their delivery date and use. Lockheed sought recovery for the added cost resulting from the delay and disruption caused by this and other changes.

Beginning in February 1969, the Navy subjected the claims to an extended investigation. Naval Ship Systems Command (NAVSHIPS) established two different teams to investigate the claims. They made numerous visits to Lockheed's Seattle facilities. In the fall of 1970, the Navy offered to settle the claims for $58 million. Lockheed rejected the offer and negotiations continued. On January 29, 1971, Lockheed and representatives of NAVSHIPS reached a tentative agreement to settle the claims for $62 million. However, final approval was never granted by the Chief of Naval Material or by the Assistant Secretary of the Navy.*

In March 1971, NAVSHIPS submitted the proposed $62 million settlement for review and approval by the Naval Material Command's (NAVMAT) Contract Claims Control and Surveillance Group (CCCSG), chaired by Gordon Rule. After several weeks, the CCCSG refused to approve the proposed settlement because of factual inadequacies and lack of substantiation. Accordingly, in August 1971 NAVSHIPS withdrew the proposal from CCCSG consideration. Later in August 1971, NAVSHIPS requested SUPSHIP-13 (the office responsible for administration of the Lockheed contracts) to assemble a team to obtain improved substantiation of the proposed settlement.

In June 1972, the NAVSHIPS Claims Board recommended approval of the $62 million settlement and NAVSHIPS again submitted the proposed settlement to NAVMAT for review. Six months later, the NAVMAT Claims Board (CCCSG no longer existed) determined that the settlement was unsupported, and withheld approval. In January 1973, NAVSHIPS again withdrew the submission from NAVMAT consideration. Since settlement approval had not been granted, the routine review procedures were re-instituted and, in June 1973, the Navy's contracting officer determined that the Navy owed Lockheed approximately $7 million. In the meantime, in May 1973, Lockheed had appealed the Navy's refusal to implement the $62 million agreement to the ASBCA. Lockheed also appealed the contracting officer's decision, which the ASBCA consolidated with Lockheed's first appeal. In May 1975, the ASBCA issued its opinion, ordering the Navy to pay the $62 million because the Navy had led third party financial institutions to rely on the tentative settlement in extending loans to Lockheed. The ASBCA decision mooted Lockheed's second appeal and, therefore, the ASBCA did not reach the merits of the claims. The Navy moved for a rehearing, which was denied by the ASBCA in October 1975.

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* By a January 1970 revision, Navy Procurement Directives required the approval of the Assistant Secretary of the Navy (Installations and Logistics) for all claims settlements in excess of $5 million.

While the ASBCA appeals were pending, Lockheed and the Navy resumed settlement discussions. During the course of these discussions, the Navy became suspicious about the steel component of Lockheed's claim and referred the matter to the Department of Justice in December 1974.

Bath

Bath claimed equitable adjustment for the costs incurred as a result of the late and defective plans for the construction of oil tankers it received from the Navy's design agent. The procedure for reviewing the Bath claim was different than that use in the other cases because the tankers were being purchased by a private company Marine Ship Leasing Company (MSLC) that would then lease them to the Navy. The contracts provided for private arbitration of any claims, with the Navy to pay through added charter fees on claims the arbitration panel allowed.

Bath's claims went into arbitration in September 1975, with Bath seeking $18.8 million and MSLC counterclaiming for $5.1 million. The arbitration panel issued its decision in January 1980, making Bath a net award of approximately $5.5 million. The matter was referred to the Criminal Division in January 1978.

Electric Boat

Electric Boat was a follow yard in the construction of SSN 688 submarines. In January 1971 the Navy awarded Electric Boat a fixed-price incentive contract with escalation, with a ceiling price value of $428 million,* for seven "Flight I" submarines. In October 1973 Electric Boat was awarded the "Flight II" contract for seven submarines, which included an option for four more submarines. The Navy exercised its option in December, making the total value of this contract at ceiling price $847 million. In February 1975, Electric Boat submitted a claim for $220 million on the Flight I ships. This first claim was based primarily on the unsuitability and late delivery of the working plans provided by Newport News, the lead year and design agent for the 688s. The Navy and Electric Boat settled this first claim in April 1976 for $97 million. The Navy, acknowledging that delay had resulted from design agent problems and that this delay had affected the timeliness of submarine construction, added a year's extension to the delivery dates of all Electric Boat SSN 688's. At the same time, Electric Boat agreed to submit additional claims by December 1, 1976. The company filed a claim on that date for $544 million. This claim related both to the Flight I and Flight II contracts. The December

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* This allowed Electric Boat 5.7% cost growth (Detailed Analysis of Navy Memorandum Decision on Electric Boat 85-804 Relief in U.S. Congress, Senate, Committee on Armed Services, Hearings on Proposed Action Under Public Law 85-804 Relating to settlement of Navy Shipbuilding Claims, 95th Cong., 2nd Sess., p. 64).

1976 claim was, like the February 1975 claim, based primarily on the effect of late and unsuitable plans. Electric Boat claimed that many of the plans it received from the lead yard, Newport News, contained "unsuitable data items" — i.e., drawings calling for unnecessarily complex and uneconomical methods of construction that Electric Boat had not anticipated at the time it submitted its bid. Electric Boat's claim sought reimbursement for the extra costs incurred as a result of the allegedly unsuitable data items as well as for government-caused delay. The December 1976 claim included $423 million for Flight II.

Beginning in March 1977, a team of technical and legal personnel of the Navy Claims Settlement Board, headed by Rear Admiral F.F. Manganaro, subjected the claim to extensive study. In February 1978, that Board recommended a settlement award of $125 million for the Flight II claims. Electric Boat refused to accept this amount as a full and final settlement. In February 1978 the Navy requested the Justice Department to investigate allegations of fraud in the Flight II claim. The Electric Boat claims were finally settled in June 1978, in connection with a multi-million dollar contractual modification under P.L. 85-804.

APPENDIX C

Detailed Histories of the Lockheed, Bath, and Electric Boat Investigations

Note: The information in this Appendix is derived from interviews, as well as documents in the Criminal Division files. The interviewees relied largely on their recollections from months and years ago. Many, but not all, of their statements were verified by documents. In some instances, we did not find documents describing events in the same detail as the interviews.

Lockheed

The Navy referred the matter to Justice in December 1974. Lockheed Shipbuilding and Construction Company is located in Seattle, and the Seattle office of the FBI initially assigned one agent to the case, expecting him to handle it along with his other cases. That agent quickly realized that the case was far too big for him to handle alone, and the FBI temporarily reassigned agents from other areas of the country to this investigation. The FBI team included as many as eight people. The Fraud Section assigned the case to one attorney.* He stayed with the matter throughout the investigation but handled other active matters during his work on Lockheed.

The section attorney negotiated an arrangement by which Lockheed produced documents in Seattle, and, by late spring of 1975, six to eight FBI agents were working full-time reconstructing Lockheed's steel transactions. After the transactions had been reconstructed, two or three of the agents were reassigned. The rest remained to audit the reconstructed transactions and to interview past and present Lockheed employees.

The Fraud Section attorney was not stationed in Seattle, although he visited once or twice during the work on the steel claim, and the agents talked to him regularly by telephone.

In September 1977 Lockheed's attorneys submitted a 243-page argument against indictment, and the two principal FBI agents prepared and forwarded to the Fraud Section attorney a multi-volume report on the investigation.

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* He had some limited assistance from a second Fraud Section lawyer.

A grand jury was empaneled in Alexandria, Virginia in June 1978. After the grand jury completed its work, there was an effort to draw the evidence together but little additional investigation. The principal FBI agent flew to Washington for a week in the winter of 1978 - 1979, and reviewed the case thoroughly with the Fraud Section attorney, referring to documents and work papers the agent brought with him.

The agent and the attorney distilled the investigation to nine or ten areas of concern. In accordance with an earlier agreement, the Fraud Section attorney met with Lockheed's attorneys and identified these areas. Lockheed's attorneys submitted a lengthy response in June 1979, and the Criminal Division sent out declination letters to the FBI, Lockheed's atorneys, and the Navy in September and October 1979.

Bath

The Bath matter was referred to the Criminal Division in January 1978. The FBI decided that the case should be handled in Maine, and assigned the investigation in November to the agent who followed it through to completion.

At the attorney level, the matter was originally assigned by the Fraud Section to one attorney who was to supervise both that investigation and the Electric Boat and Newport News matters. The plan was to assemble for each case a working team to include attorneys from the Fraud Section, the Navy, and the relevant U.S. Attorneys' Offices. This plan was not carried out in the Bath matter, in part because the USAO in Maine did not want to handle the case. Line attorney responsibility passed to one Fraud Section attorney, who did little with it, then to another Fraud Section attorney who began working on it January 1979, but who had other active matters to work as well.

An organizational meeting took place in Maine in January 1979, attended by the FBI agent, an NIS agent just assigned to the case, the Fraud Section attorney who had just been assigned to it and the Military Sealift Command (MSC) attorney who had negotiated the series of contracts financing construction and also had supervised the arbitration.

The FBI and NIS agents spent about two weeks in February at MSC headquarters, learning about Bath's claim from the MSC attorney. The Fraud Section attorney participated in some of these meetings. In April, the agents were briefed by the New York attorneys who had conducted the arbitration on the government's behalf. In May, the agents began to interview former Bath employees. Bath began producing documents during the summer. The FBI and NIS agents spent full time on the case in Maine, examining the thousands of documents Bath had produced and interviewing witnesses. In August, the FBI brought in about eight additional agents to work on the matter temporarily. They were briefed, and participated in a series of interviews designed to obtain the stories of several Bath employees at about the same time so as to minimize their opportunity to coordinate statements.

The Fraud Section attorney, who had other duties, flew to visit the agents about every two months. Beginning in January 1980, a second Fraud Section attorney assisted on the case. He made three to four trips to Maine with the first attorney during the period January to July. However, he too had other responsibilities. Beginning in January 1980 a Naval Audit Service auditor spent about two months examining the Bath claim to help the investigators. One witness was called before a grand jury in Maine in May 1980.

Due to conflicts between the agents and the first Fraud Section attorney, which in retrospect seem to have been largely differences in style, the second Fraud Section attorney assumed leadership of the investigation in July 1980. At the same time, a Fraud Section supervisor asked the agents to prepare a memorandum to assist the Section in reviewing the matter. The agents submitted their memorandum in August. The second Fraud Section attorney, who had devoted virtually full time to the case since assuming leadership, submitted a memorandum in September, and an indictment review committee met in that month. The NIS agent was reassigned from the case to Washington headquarters in September 1980, and in October, the FBI submitted an additional memorandum summarizing the evidence.

After the indictment review committee meeting, the Fraud Section decided to bring more witnesses before the grand jury. The FBI agent on the case was transferred to Providence in January 1981. In October 1980 and March 1981, witnesses testified before the grand jury. One additional witness testified in deposition later in Washington. In June, the MSC attorney submitted a summary of the grand jury testimony, and a Fraud Section supervisor discussed the case in Washington with the NIS agent, the MSC attorney, the FBI agent, and an FBI supervisor. In September, the Fraud Section supervisor wrote a memorandum recommending against indictment. In January 1982, a final declination letter was sent by the Assistant Attorney General for the Criminal Division to the Navy and the FBI.

Electric Boat

This matter was referred to Justice in February 1978. The FBI assigned agents to the case in July 1978. By the end of the year, they had formed an investigative task force that included three or four on-site FBI agents, four other FBI agents brought in on a temporary basis, and an NIS agent. The Navy assigned the Groton-based leader of the Navy claims evaluation team to work part-time on the task force. The task force familiarized itself with both the claim and the analysis of it prepared by the Navy, identified candidates for interviews, and interviewed former employees and a few present employees. After a few current employees had submitted to interviews, Electric Boat workers refused further interviews outside the presence of the corporation's attorneys.

At the attorney level, supervisory responsibility was assigned to the Fraud Section attorney also initially supervising the Bath and Newport News investigations. Line attorney responsibility was assigned to an Assistant United States Attorney (AUSA) in Connecticut and a Fraud Section attorney, who were to work with a Navy attorney on the case. The AUSA soon became a magistrate and the Fraud Section attorney became an Economic Crime Specialist. The Navy attorney provided some leadership, but eventually moved on to other duties. The Fraud Section assigned a different attorney to the case in about May 1979. That attorney stayed with the matter to the end of the investigation, and worked on it full time while it was active.

Since Electric Boat personnel were insisting on attorney presence during interviews, the investigation shifted to the grand jury in the spring of 1979. The Fraud Section attorney spent his weekdays in Connecticut. Since few interviews were being conducted, the task force was scaled down to three FBI agents, (two after one was transferred to Atlanta in April 1980); two engineers on contract to the Navy; one agent from NIS; and the Navy engineer who had supervised the claims evaluation in Groton and who devoted only part of his time to the investigation. A second Fraud Section attorney spent between six weeks and six months (recollections differ on this point) on the case. When he was in

Connecticut, the grand jury met weekly rather than bi-weekly. The investigative team spent a large part of its time sitting around a table in a room in the Hartford Post Office Building, reviewing the documents subpoenaed by the grand jury and preparing questions for grand jury witnesses.

In response to disagreements between the principal FBI agent and the principal Fraud Section attorney, the Chief of the Fraud Section asked for a report, which the attorney submitted on January 16, 1980. It provided a history of the investigation, theories of prosecution, a summary of some of the grand jury testimony to that date, and plans for further grand jury work. After additional grand jury work, the attorney prepared a prosecution memorandum dated July 29, 1980.

After an indictment review committee meeting at the end of July, the Chief of the Section discussed the investigation with the line attorney's supervisor, and they agreed that there appeared to be no case. However, the declination was deferred pending review of a submission from defense attorneys, partly on the chance that it might raise some new possibilities for investigation.

The defense attorneys submitted a multi-volume document in August 1980, presenting their case against indictment. The Fraud Section Chief wrote a memorandum to the Deputy Assistant Attorney General supervising the Fraud Section in late July or August, stating that a new grand jury (the old one having expired) would examine three specific issues. After the line attorney submitted a second prosecution memorandum and an October 30 memorandum describing the new grand jury testimony, his supervisor wrote a

December 1, 1980 memorandum to the Fraud Section Chief recommending against indictment. The FBI then asked for additional time to follow up a lead in New Jersey, and the Fraud Section agreed. As it turned out, the New Jersey evidence was not helpful.

In February 1981, the FBI made a presentation to the Fraud Section in order in support of further investigation based on the LARS (see page 32 above). The Fraud Section agreed and further grand jury work followed.

In April 1981, the Fraud Section Chief and the line attorney's supervisor went to New London to personally examine subpoenaed documents and read grand jury testimony. They also performed similar work in Washington, with the Chief even dictating summaries of key portions of grand jury testimony. Defense attorneys met with the Assistant Attorney General for the Criminal Division and asked that the Department reach a decision quickly, one way or another. In August, a last grand jury subpoena was served on Electric Boat, which completed its final document production in September.

In October, the line attorney's supervisor wrote a file memorandum concluding that no indictment should be sought, and, in November, the Fraud Section Chief wrote a memo to the Assistant Attorney General for the Criminal Division containing the same conclusion. In December, the Assistant Attorney General chaired a meeting to discuss the investigation, that was attended by the principal FBI agent, FBI supervisors, the Fraud Section line attorney, his supervisor, the Chief of the Fraud Section and the Deputy supervising it. On December 18, the Assistant Attorney General informed the Bureau and the Navy, by letter, of the decision to decline.

EXHIBIT GG

AUGUST 23, 1983 -- MEMO FROM OGREN TO JENSEN

AUG 23 1983

Newport News Shipbuilding Investigation

RWO:MBS:sag
113-74-25

D. Lowell Jensen
Associate Attorney General

Robert W. Ogren
Chief, Fraud Section
Criminal Division

I have reviewed the memorandum dated May 18, 1983 of United States Attorney Elsie Munsell and Messrs. Aronica, Fisher and Smith regarding Newport News Shipbuilding ("NNS") and have also reviewed Mr. Fisher's separate undated supplemental "chronology." These memoranda disagree sharply with the conclusions and recommendations contained in my memorandum on the same subject dated February 25, 1983. The position of the Alexandria prosecutors as expressed in the May 18, 1983 memorandum is that based on existing evidence, it would be appropriate to charge NNS and unspecified employees in a two-count conspiracy indictment, one count charging a violation of 18 U.S.C. §286 (conspiracy to file false claims) and the second a violation of 18 U.S.C. 371 (conspiracy to defraud the government by overloading the claim process with voluminous meritless claims). In my view the evidence is insufficient to support either charge. I have summarized in this memorandum the evidence that we believe would be available to support the conspiracy charges they have recommended. At a meeting on this subject held on August 18, 1983, the Alexandria prosecutors indicated that it is now their position that it is not feasible to proceed in this matter.

At the outset several observations should be made. The Alexandria prosecutors in their May 18, 1983 memorandum recommend proceeding only on conspiracy charges, it being their position that the statute of limitations on substantive false claims offenses ran on August 1, 1982.[1] To prove either conspiracy would require evidence showing that claims were false or frivolous on their face and evidence that showed an agreement among officers and employees of Newport News Shipbuilding (NNS) to submit false claims and/or to jam the claims evaluation process to the point that it disfunctioned.

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[1] At the August 18, 1983 meeting, the Alexandria prosecutors have abandoned the position that false claims charges should be brought (see May 18, 1983 memo, p. 2 f.n. 1a) on statute of limitations grounds.

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However, the Alexandria prosecutors' memorandum of May 18, 1983 does not clearly identify the evidence they would rely upon to prove the charges they propose. They indicated at the August 18, 1983 meeting that they were not able to put together an indictment or offer of proof or they would have done so in connection with their May 18, 1983 memo. They do suggest, however, at several points in their memo, evidence they regard as central to proving their case. In addition, the key elements of proof they would rely upon were identified at our August 18, 1983 meeting. In the main, it appears that they would rely on the claims themselves, CITARS and documents such as the [redacted] memo. They would also rely on testimony from Admiral Rickover's Deputy, Navy experts and Messrs. Weed, Cardwell, Eubank and Walsh. Finally, they would rely on inferences drawn from changes made from earlier drafts of several of the claim items. We believe Weed and Cardwell, Newport News employees involved in the claims process, to be extremely weak witnesses. We doubt that Eubanks and Walsh would help the Government's case, and the May 18, 1983 memorandum gives no clue as to how they would be used.

At the August 18, 1983 meeting, the Alexandria prosecutors indicated that proof of the conspiracy could be shown by the fact that the "accountant booked $200 million" (in the initial stages of the claims process). We note that the Richmond prosecutors investigated to determine if the target value was established first and the claims were being written to fit this monetary goal. After a team of accountants and investigators reviewed this matter, they concluded "Top Management at NNS did not write or rewrite the claims to fit predetermined target values". The Navy attorney assigned to the Richmond prosecution team also agreed that "no documentory or witness evidence was found that the direction for the amount of the claim came from the top".

Our view of the evidence is spelled out below.

I. Review of Conspiracy Evidence

a. Conspiracy to Defraud the United States, 18 U.S.C. 371.

As noted in our memorandum of February 25, 1983, this conspiracy theory is essentially one to submit voluminous meritless claims in order to overload the claims process.[2] The theory assumes that NNS advanced claims based

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[2] The February 25, 1983 memorandum sets out the legal deficiencies of this theory. Those may be found at pp. 17-18 of that memo and will not be repeated here.

on frivolous entitlement theories which it knew were non-meritorious. We know of no testimony from any Newport News claims writer or any other evidence to support this theory. [redacted] The Alexandria prosecutors suggest that Messrs. Weed and Cardwell be called as witnesses in support of this theory. They concede, however, that neither Weed or Cardwell can testify to any significant conspiratorial conversations nor can they testify that any of the claims prepared were fraudulent. Ironically, one item of proof originally advanced in the Alexandria status report in support of this conspiracy theory-the decentralization of the claims process-they have now characterized as neutral. Finally, they rely on the [redacted] which in my view is exculpatory. No other evidence has been suggested as supporting this theory except the claim items themselves.

It should be further noted that all of the cases under the *Hammerschmidt* conspiracy theory contain some element of deception, trickery, and dishonesty including the *Shoup* case which is heavily relied upon the Alexandria prosecutors.

B. Conspiracy to File False Claims.

As in the case of the conspiracy to defraud theory there is no evidence tending to prove that any specific individuals were involved in a plan to submit false claims. [redacted] Those [redacted] clearly undermine the Alexandria prosecutors' theory. We have no witnesses prepared to testify about the plan to submit false or meritless claims, nor are there any likely candidates to be developed as prosecution witnesses. As noted in the February 25, 1983 memorandum, there is some evidence that certain of the claims filed may have been false. However, there is no evidence which links the filing of individual claim items to an overall conspiracy. In addition, the circumstances under which the claims were created, the separation of the claim writers from those preparing the pricing figures, the elimination of more than 100 items and the reliance on advice of counsel all negate fraudulent intent which would be an essential element of proof.

c. Individual Claim Items

The 14 claim items that we reviewed present a variety of evidentiary problems. However, in a conspiracy prosecution under 18 U.S.C. §286 the dominant problem is the absence of any evidence linking the claim writers' actions to a conspiracy. Indeed as to several of the claims, the investigation is so incomplete that we do not even know the identity of the writer.

For your convenience, I am below summarizing in profile fashion the present state of the evidence on each of the so-called false claims that were encompassed in our review.

1. Ventilation Control Air System - As described in my memorandum of February 25, 1983, we can prove that the Navy's design specifications were not "vague and ambiguous" as claimed. The Alexandria prosecutors did not develop evidence to prove who knew the specifications were not vague and ambiguous. Nor is there evidence indicating who had knowledge of the language in the claim and also assisted in its submission. [Note: this claim was withdrawn before settlement].

2. Discharge Sea Chest - This item is largely uninvestigated. [Note: Technical legal problems likely in attempting to present this as a false claim].

3. Reactor Shielding - Virtually uninvestigated. Nothing is known about who prepared the claim, what documents were reviewed or what instructions were given. On its face this is the most technical of the claim items reviewed and by far the least comprehensible to the layman. We see virtually no prospect for further investigation to be conducted in a reasonable time period.

4. OSHA and EPA - No investigation has been conducted although we would agree that had this been fully investigated some time ago it conceivably could have been developed into a viable false claim.

5. Bow Dome - The Richmond prosecutors developed some evidence of falsity. This claim item has been investigated rather fully with evidence that [redacted] were of the view that the item should be dropped. Evidence is clear that this item was included as a result of advice by attorney Henry Beauregard. Subsequently, and immediately prior to settlement, the questionable accuracy of the item was disclosed by Newport News. Given the advice of counsel problem and disclosure, this item has no merit. In addition, of course, there is no evidence linking this claim item to a conspiracy. [Note - at our August 18, 1983 meeting Assistant United States Attorney Fisher described this as a "strong" false claim, notwithstanding the obvious defenses].

6. Cathodic Protection - Investigated fully by the Richmond prosecutors. [redacted] As in the case of the Bow Dome item,

immediately prior to settlement the questionable accuracy of this item was disclosed by Newport News. [Assistant United States Attorney Fisher described the evidence regarding this claim as strong, notwithstanding the obvious defenses].

7. Cooper Nickel Tubing - Investigated and no evidence of falsity found [Note - the Alexandria prosecutors did not include this item among those recommended for further investigation].

8. Intermediate Gauge Cut Out Valves - Investigated by the Richmond team. [redacted] In any event it was withdrawn 7 months before the settlement. In addition to several technical problems all evidence is consistent with innocence.

9. Nimitz Delay - The Richmond investigation failed to develop clear evidence that this claim based on delay was falsified. The claim item specified 100 delaying events. Investigation developed evidence proving that 95 of them in fact occurred. Proof on the remaining 5 items is unclear.

10. Eisenhower Delay - Shipway Utilization - A Richmond investigated claim. Evidence was developed that the original claim item might have been inaccurate, at least in the sense that the Navy understood it. However, the evidence also shows that the claim item was amended by NNS in 1977 (the year before settlement) to clear up the inaccuracy. No other evidence of falsity was ever developed with respect to this claim item.

11. Eisenhower Delay - Interbottom Shielding - A Richmond investigated claim. The investigation results tended to support the conclusion that the claim was accurate.

12. Added Interest - This is in the fully disclosed but "outrageous theory" category. There is no evidence linking this claim item (actually, it is included as a portion of each separate claim item) to a plan to submit outrageous claims.

13. Navy Recuiting - Fully investigated by the Richmond team. The claim is in the "outrageous" category. There is no evidence of criminal intent. [redacted] In the context of a conspiracy case, there is no evidence linking any alleged falsity of this claim to a plan to submit false claims. [Note, although "outrageous", the theory of recovery was fully disclosed in the claim item itself].

14. Fictitious Manhours - Deterioration of Labor - Investigated by the Richmond prosecutors. We have no evidence that the preparer of the claim acted in concert with others or pursuant to instructions. Moreover, the claim item clearly is not fraudulent on its face because it fully discloses its basis of calculation and revealed that the basis was an estimate rather than predicted on a calculated of actual time lost. There is no evidence of any deception.

Miscellaneous Comments

The most recent Alexandria memoranda are filled with questionable or erroneous assertions of facts. Three, however, do deserve specific comment.

[redacted]

However, it should be noted that after discussing them with Mr. Weiner, we did not find them particularly probative

[redacted]

3. The May 18, 1983 memorandum attributes to Mark Richard an assessment of the strength of the case that he has advised me does not accurately reflect his views. Indeed, Mr. Richard has stated he is totally unfamiliar with the evidence in the NNS matter having merely skimmed the report forwarded to him by Mr. Fisher as a courtesy.

Conclusion

It is still my recommendation that prosecution be declined and the investigation terminated.

EXHIBIT HH

AUGUST 30, 1983 -- JENSEN DECLINATION LETTER

U.S. Department of Justice

Office of the Associate Attorney General

Washington, D.C. 20530

AUG 30 1983

Mr. Walter T. Skallerup
General Counsel
Department of the Navy
Washington, D. C. 20350

Dear Mr. Skallerup:

By letter dated February 6, 1978, your office referred to the Department of Justice allegations that Newport News Shipbuilding and Dry Dock Company ("Newport News") submitted false claims to the Navy in connection with cost overruns related to the construction of 14 nuclear powered vessels. The claims for equitable adjustment sought by Newport News totaled $894 million dollars.

The lengthy investigation conducted in this matter included interviews of several hundred persons and review of thousands of documents. The investigation was substantially assisted by an able team of FBI agents and Navy investigators working with attorneys from the Navy, the United States Attorney's office for the Eastern District of Virginia,and the Criminal Division of the Department of Justice.

After review and analysis of the evidence in this case, it is our conclusion that criminal prosecution of Newport News and its officials is not possible. Although a number of factors support this conclusion, the dominant reason influencing our judgment is the absence of sufficient evidence to prove the existence of a criminal conspiracy to submit false claims or to defraud the United States. We would welcome the opportunity to discuss our conclusion with you at greater length should you wish to do so.

It is our view that the prosecution of shipbuilding cost overrun cases is made extremely difficult because of the manner in which the claims process is operated. Because of the problems in these cases, the Criminal Division's Office of Policy and Management Analysis has undertaken a review of our experience with these cases and has made several recommendations that should improve the capacity to respond to such overrun claims and handle investigations regarding those claims more effectively.

Should you wish to discuss our decision in this matter at greater length, I suggest that you contact Robert W. Ogren, Chief, Fraud Section, Criminal Division (724-7038).

Sincerely,

D. Lowell Jensen
Associate Attorney General